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AGRICULTURAL AND CREDIT OUTLOOK '82

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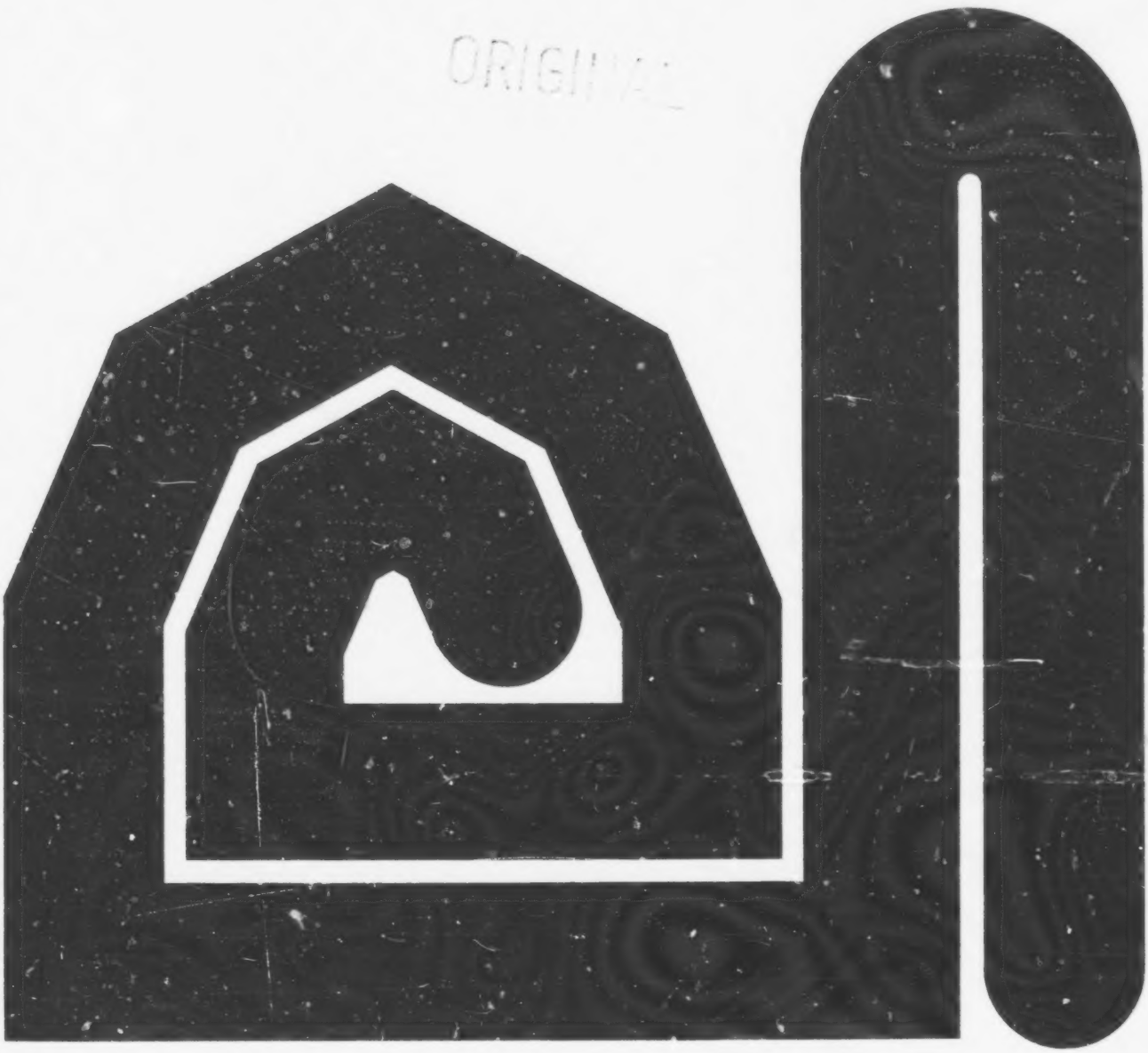

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FOREWORD

A team of Farm Credit System and Farm Credit Administration personnel undertook a project of interpreting and summarizing the annual Food and Agricultural Outlook Conference of the Department of Agriculture, November 2-5, 1981. The team represented a broad range of expertise in agricultural economics and credit. This was the tenth year of an effort to focus attention on the agricultural economy and to look at prospects for agricultural finance in the coming year.

The activity provides a once a year overview of the interactions of various commodity situations, production input costs, trends in output utilization, and changes in stock levels. A timely digest of these influences provides a point of departure for independent judgments and plans of operating in providing agricultural finance to farmers and their cooperatives.

In addition to summarizing the views presented at the Outlook Conference, the report presents a more detailed assessment of the general economy and of agricultural credit conditions by FCA economists. Comments on policies and programs are intended to describe their likely economic impact and do not imply an FCA position in either support of or opposition to them.

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I. HIGHLIGHTS

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• Output for the year will grow by less than 1 percent as the 1981 recession spills into 1982.	4
• Recession is causing the 1982 deficit to rise and has meant the abandonment of a 1984 balanced budget.	4
• Short-term interest rates will continue volatile, but will likely ease several percentage points from average 1981 rates as private credit demands abate.	6
• Consumers will invest increased savings in Treasury securities, alleviating some of the upward pressure on interest rates caused by Treasury borrowing and tight monetary policy.	9
• Agricultural exports, aided by a decline in the value of the dollar, will set a new record for the 13th consecutive year, again helping to offset trade deficits in other sectors.	8
• Inflation will decelerate to 8-9 percent from 10.5 percent in 1981, as food and energy prices and wage increases slow.	7
• Unemployment will range between 8.5 and 9 percent in the first half of the year—the highest since the recession of 1975.	4
• Tax cuts and interest income will aid the growth of real disposable personal income by more than the growth rate from wages and salaries.	9
• Resumption of spending by business for productive purposes is critical to economic recovery in 1982.	9
AGRICULTURAL ECONOMIC OUTLOOK	
• Net farm income is projected to fall short of the depressed $20- $22 billion levels of the past 2 years.	12
• Farm cash receipts are expected to increase moderately—at half the rate that costs will rise—creating a more serious cash flow problem in early 1982.	12
• Production cost increases should moderate, especially for livestock producers buying feed.	15
• Interest charges will put upward pressure on production expenses for the second straight year.	15
• A third straight year of depressed farm earnings will cause a difficult adjustment period for some producers, their lenders, other farm input suppliers, and the farm real estate market.	13
• Despite dismal near-term prospects, the longer term agricultural outlook is reasonably bright. Even during 1982, a shift toward a more balanced market psychology could swiftly change the agricultural outlook.	10
• Off-farm wage income may not be as reliable a source of repayment ability as it has been because of the recession.	14, 30
• Exports are critical to the U.S. farm sector; a rebound to rapid volume growth may be difficult to achieve, given sluggish economic growth in many importing countries.	11
• Food prices are expected to increase about 7 percent due to pressures from increased marketing costs.	16
FARM AND TAX LEGISLATION OF 1981	
• Income tax cuts will have little direct effect on farmers in 1982 because of low incomes. Worse, an immediate impact of these cuts will be to keep upward pressure on interest rates.	17
• Estate-tax changes will help farmers to pass on land to their heirs.	17
• New commodity legislation, designed to lessen Federal budget exposure, continues the course established in the 1970s toward greater market orientation.	18
• Other changes in USDA progams will also reduce the amount of risk protection afforded.	18

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AGRICULTURAL FINANCE OUTLOOK

- Continued adjustment to adverse conditions are expected to characterize agricultural finance in 1982. Weak cash flows will force further postponement of land and capital item purchases by many farmers and ranchers. 19
- Although farmers will lean heavily toward reducing their debt exposure, the need to extend or refinance debt that would have been paid down in better times may force growth in farm liabilities beyond the seasonal expansion necessary to finance current production. 19
- Inflation is expected to outpace rates of farm land price appreciation, causing the third reduction in purchasing power of farm assets in as many years. 20
- Continued unfavorable shifts in the farm balance sheet may cause the sector's debt/asset ratio to rise to a level not seen since early in World War II. 24
- Heavy emphasis on loan servicing is expected throughout 1982. Delinquencies, defaults, and foreclosures are expected to show some increase. 19, 30
- As in past times of stress, the quality of farm loans will vary tremendously. Many farmers will maintain a very healthy financial condition. A few will be driven to liquidate or refinance at least part of their operations. 19, 24
- Most agricultural lenders should have ample funds available for those who are creditworthy. 19
- Despite policy shifts toward market orientation, some Government farm lending programs may loan at record levels in 1982. Although all program specifics are not yet final, CCC lending may be especially vigorous. 29
- FmHA lending for farm ownership and operating loans is expected to continue at about the same levels as in recent years. Disaster lending will be subject to tighter eligibility standards. Status of the economic emergency lending program depends on the outcome of the 1981 Farm Bill. FmHA borrowers, however, can expect to be reviewed more closely for potential graduation to private lenders. 24, 30
- SBA farm loan programs will be phased out during 1982. SBA farm lending in 1982 is expected to total about $200 million. 29

OUTLOOK FOR COMMODITIES

- Projected crop prices in 1982 are generally below average total cost of production, with the exception of fruits, vegetables, and tobacco. This will cause economic stress for some producers, particularly highly leveraged operators and tenant farmers, and those who had 2 or more years of poor crops prior to 1981. 32
- Livestock producers may earn positive net margins intermittently during 1982 due to lower feed costs, but the real key to improvement rests with a boost in demand from a stronger domestic economy—some help in this area is being counted on during the second half. 32

Meat, Dairy, Poultry and Eggs

- Retail supplies in 1982 will be slightly larger, with less pork continuing to be offset by more beef and poultry. 33
- All sectors of the cattle industry are expected to have another financially difficult year. 34
- Pork production will be reduced 4-5 percent from 1981, yielding modest price strength and somewhat better feeding margins. 35
- Broiler output will slow to about a 1-percent increase during the first half. 36
- Large frozen turkey stocks will depress turkey prices during the first half and moderate the expected rise in broiler prices. 37
- Sheep and lamb output will continue the recent uptrend, but large total meat supplies and static demand will bring lower prices. 36
- Dairy production will continue in excess of commercial demand during all of 1982. The support price will hold constant, meaning that profit margins will narrow as costs rise. 38

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- Egg production will continue steady, to lower, allowing some price improvement and better margins due to some lowering in feed costs. 37

Grains

- Record or near-record 1981 world production of feed grains and sluggish demand continue to exert downward price pressure during at least the first half. An exception is oats which has almost become a specialty crop. 38
- Improvement in export demand and increased feed utilization could provide some support to domestic feed grain prices later in the year. World production prospects during 1982 will be a price factor by mid-year. 40
- Producers are expected to make heavy use of the regular and the farmer-held reserve loans of the Commodity Credit Corporation. 40
- Despite record world production of wheat, there is still a relatively tight world stock situation. 41
- Strong export demand should support the U.S. wheat price near 1980/81 levels during the 1981/82 crop year. 42

Oilseed and Fibers

- The 1981/82 oilseed outlook is dominated by large supplies and lower prices, particularly for soybeans, which account for 85 percent of our oilseed output. 42
- A good harvest has rebuilt soybean stocks to near-record levels. Even with moderate increases in both domestic use and exports, there appears to be little hope for more than seasonal movement in prices before summer. 43
- U.S. peanut production made a sharp recovery from the drought-reduced 1980/81 crop. Exports of peanuts are not expected to reach 1979/80 levels and some rebuilding of U.S. stocks will result. 43
- A major factor affecting the peanut outlook in 1982 and beyond is the peanut program in the new Farm Bill. 44
- Anticipated large world cotton supplies and sluggish world demand have caused cotton prices to decline sharply. The prospect of modestly improved exports should support cotton prices at current levels during the 1981/82 crop year. 44

Other Crops

- Tobacco is projected to continue as one of the world's most stable crops with a favorable economic outlook in the U.S. While the tobacco program escaped change in the 1981 Farm Bill, Congress mandated that USDA study the provisions and examine possible alternatives. 44
- High worldwide production of sugar will keep the price well below 1980's average of 30.1 cents a pound. 46
- Although production of potatoes is up 8 percent, farm prices should remain in the range of $4.75 to 5.25 per cwt., due to good demand prospects—one food that does well in a weak economy. 45
- Fresh and processed vegetable supplies should continue to be tight and prices will be higher during the first quarter of 1982. In response to higher prices in 1982, plantings and production of most major vegetables should expand during the spring and summer of 1982. 46
- For the first time in several years, production of citrus and non-citrus fruit dropped from a year ago—down almost 10 percent during the 1981/82 season. 47
- Large almond, pecan, and walnut crops have combined with adequate carry-in stocks and foreign production to ensure large supplies of the major edible tree nuts during 1982. 48
- The demand for timber is likely to remain weak due to still-high interest rates discouraging residential construction activity. 48

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II. GENERAL ECONOMIC OUTLOOK

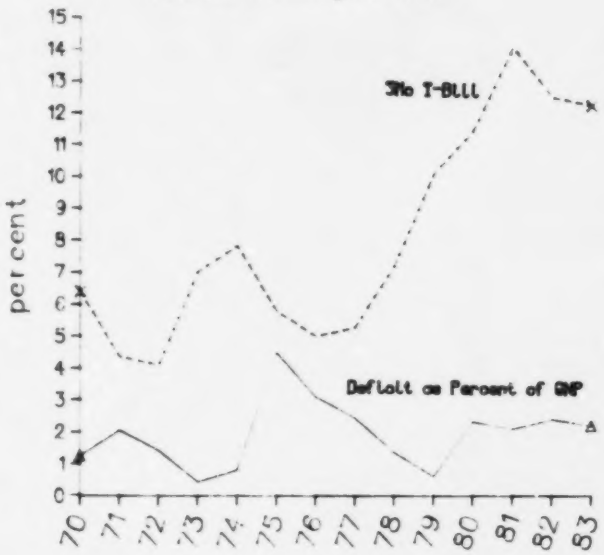
Wait Until Next Year—The *Agricultural and Credit Outlook '81* foresaw 1981 as a year of transition with any major improvements in the economy coming only with a considerable lag. This was an accurate forecast and may well be appropriate for 1982. The recession of 1981 had its greatest impact in the fourth quarter, and spilled over into this year, depressing prospects for the year as a whole. Growth may actually be negative during the first half of the year, but it is expected to improve in the second half. The quantity of goods and services produced by the economy will grow less than 1 percent. Inflation will be the better news as prices decelerate to around 8.5 percent from 1981's 10.5 percent. Interest rates will continue to moderate as inflation declines and output falls in the first quarter of the year, but then may see stiffening in the second half. Unemployment will hit a peak between 8.5 and 9 percent in the first half, bringing the rate up to its highest annual level since the recession of 1974-75. It will not start to turn down until the second half after production begins a second quarter increase.

Transition in Government Role—A Rough Economic Road—The battle of the budget in 1981 centered around the wide gap between reductions in outlays and reductions in taxes over fiscal years 1982 through 1984. The cut in taxes sought by the Administration and passed by Congress was almost six times the cut in expenditures. These changes were designed to make a longer run change in the role of Government and encourage the private sector, but the short-run result is a difficult transition. Supply-side economics forecasts that increased incentives brought about by higher after-tax income will spur investment and output, increasing income and swelling Treasury revenues above what they would have been without the tax cut.

For the last 15 years or so, each new administration has promised a balanced budget, and each has failed to achieve its promise. Financial markets understandably are skeptical and are awaiting concrete evidence that the Treasury's presence will leave some room for other borrowers. This will not be a problem in early 1982, as the recession is already causing slack business loan demand. But it could again be a concern later in 1982 and put new pressures on interest rates at that time.

The squall that hit the economy in late 1981 added to the Administration's woes. The *Mid-Session Review of the Budget* in 1981 estimated the 1982 deficit at $42.5 billion. Many economists immediately recalculated it at $60 billion. But the worst was still to come. The Office of Management and Budget (OMB) produced a worst case scenario late last year, raising the projected deficit to $100 billion. This may have been a stratagem to win support for more spending cuts—a policy advocated by OMB. The actual size of the deficit, over say, $60 billion, will depend on the economy. Lost revenues and greater outlays for unemployment compensation will be offset to some extent by lower interest costs, as interest rates fall with the decline in the economy. Even with these effects, the deficit could rise by another $20 billion to at least $80 billion, if there are no additional cuts in expenditures or increases in taxes. The probabilities of either occurring in fiscal 1982 are low.

Federal Budget Deficit As Percent of GNP and 3-Month Treasury Bill Rate



The large individual tax cuts put into effect under the Economic Recovery Tax Act of 1981 are not likely to be rescinded or postponed. Although these tax cuts will cost the Treasury about $27 billion in revenues, a repeal or reduction would not only diminish hopes of a pickup in demand in the second half of the year, but would also be a

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blow to the Administration's economic strategy. Expectations of increased demand produced by these future tax cuts may turn out to have been the most appropriate policy to pull the economy out of its 1981-82 slump. Further expenditure cuts and "revenue enhancement" measures such as taxes on consumption and a windfall profits tax on decontrolled natural gas are probably in the offing in fiscal 1983, which starts October 1982.

Credit Demand in 1982—U.S. Treasury—The Treasury's demand for funds in 1982 depends upon the projected deficit. It could tap the market for at least $80 billion in new money during calendar 1982. Demand in the first and third quarters could be the largest of the year. During the second quarter, when tax receipts are the largest, the need for financing will diminish. The fourth quarter will also see the Treasury's demand subsiding.

Farm Credit Financing—For the year beginning November 1, 1981, the Farm Credit banks expect to raise about $11 billion in new money and to refinance about $50 billion of maturing obligations, exclusive of very short-term discount notes. The comparable figures for the previous year were $11 billion in new money and $41 billion in maturing obligations. The increase in refinancing during 1982 reflects the shortening of maturities in recent years, especially at land banks and the intermediate credit banks. These two systems represent about 88 percent of outstanding bonds.

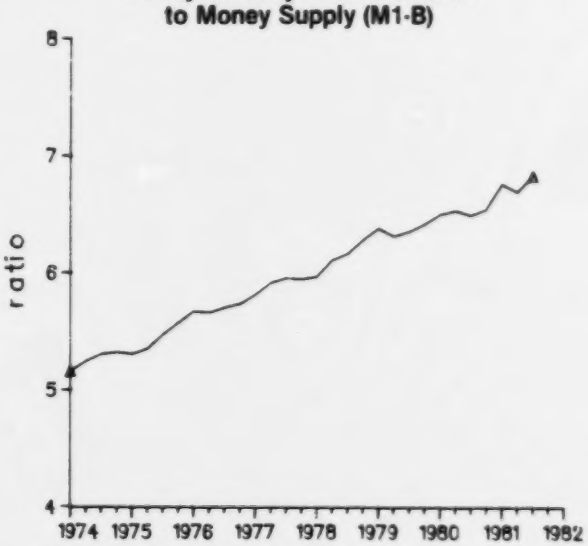
The Federal Home Loan Banks as well as Federal National Mortgage Association together will raise about $15 billion in new money in 1982, just marginally above their 1981 level.

Corporate borrowing at banks will decline significantly in 1982, while long-term borrowing will increase. Corporations will reliquefy by paying off short-term indebtedness with long-term money. Bank loans, commercial paper, and finance company borrowing could be cut by almost 75 percent in 1982, down to $13 billion from $47 billion in 1981. Some of this short-term debt will be liquidated entirely for a time as inventories are drawn down. Another part will be financed in the Eurobond market. The remainder, along with new money, will be financed in the U.S. bond market, raising the total borrowed in this market above 1981. For all of 1982, total credit demands including households, nonfinancial corporations, and the Federal, state, and local sectors will fall by nearly 1 percent from 1981. There will be an overall shift from borrowing and lending in the short-term to the long-term market.

Of All Shortages, Money is the Worst—Financial markets in 1981 were understandably skeptical about the promise of a balanced budget by 1984. Furthermore, the Federal Reserve had committed itself to a policy that did not permit it to support the Treasury's financing operations. Institutional investors stayed on the sidelines until late in the year when it became apparent that rates would not continue to rise and bond prices fall. The recession took care of the private sector being "crowded out" by the Treasury. As short-term rates fell, institutional investors returned to the long-term bond market—lowering rates for both corporations and governments. An additional source of funds during a recession is private savings, which usually grow under such a condition.

Since 1979, the Federal Reserve policy has been to set a growth rate target each year for the money supply and let the demand for funds fluctuate around a noninflationary rate of growth in supply. The large prospective deficits through 1984 seem to place the Federal Reserve in the role of chief, and only, inflation-fighter. They maintained a low growth target for the money supply ranging from 3 to 6.5 percent in 1981. For 1982, the Fed has reduced its target for M1-B (checking and NOW accounts and currency in circulation) to a range of from 2.5 to 5.5 percent.

Money Velocity—Ratio of GNP to Money Supply (M1-B)



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Assuming that the total output of the economy, including price increases, reaches $3.2 trillion in 1982, each dollar of money supply estimated at $459 billion will have to finance 6.9 transactions ($3.2 trillion/ $459 billion). Money will have to work harder this year than last when velocity was 6.7. However, as interest rates have risen over the past few years, velocity has also. For example, in 1974 velocity was only 5.2. The tendency is for corporations and individuals to economize on checking account balances and spending as opportunity costs rise. Therefore, the increase in velocity in 1982 is not excessive, but neither is it generous. If inflation gets out of hand, it could squeeze real GNP even below its estimated growth of 1 percent, as the money supply must finance both real growth and price increases.

Interest Rates—Since the Fed has demonstrated its willingness to stick to its goal of slow money supply growth even in the face of recession, there is little prospect that interest rates will fall continuously during 1982. There will be some declines through the first quarter, with the level in all categories being lower for 1982 than for 1981. Interest rate forecasts are subject to wider ranges of error than most economic variables; however, the probable patterns are outlined below.

Short-term Rates—Except for short intermissions brought about by auto industry rebates, the brunt of high interest rates early last year was felt by agriculture, autos, and housing. By the last quarter of 1981, economic declines had spread to all sectors. Domestic final sales to consumers, corporations, farmers, and governments started to fall in September and continued through the balance of the year. The drop in sales caused a pile-up of goods on the shelves of retailers, wholesalers, and manufacturers. The high cost of carrying stocks made it necessary for businesses to dispose of merchandise as quickly as possible. This lifted some of the interest cost burden from businesses. It should reduce the rate of growth in bank credit and commercial paper through the first quarter causing average short-term rates to decline from 1981 rates. Six-month T-bills will decline to an average of near 12 percent, compared with the 1981 average of over 14 percent. Rates will be variable as they have since 1979; however, as the Fed learns to control money supply on a weekly basis, volatility will subside from the average of the past 2 years.

Rates on 6-month Farm Credit bonds, which averaged 15.85 percent through October 1981 financing, might decline on average in 1982 by one or two percentage points. Quarterly averages should vary from a low of about 11 to 12 percent in the first quarter to between 13 and 14 percent in the third quarter.

Long-term Rates—The first three quarters of 1981 saw rising rates along with an unwillingness of both investors and borrowers to make long-term commitments. The recession that deepened in the fourth quarter had the beneficial effect of lowering long-term rates. Three-year governments sold by the Treasury at its regular quarterly funding operation in November yielded 14.43 percent—1.5 percentage points below the rate paid in August; 10-year bonds were .68 percentage points lower.

Bond yields had started to rise toward the end of 1980. Buyers began to demand larger premiums over current inflation rates to protect themselves from the prospect of increases in inflation, indicated by large Federal deficits and concomitant Federal financing needs. Furthermore, the extreme variability of interest rates in 1980, caused by the volatility of money supply, had resulted in huge losses in institutions' bond portfolios. This experience had such a sobering effect on portfolio managers that even a 15-percent rate of return on long-term bonds was not enough to entice them back into the market through the first three quarters of 1981. At the same time, many corporations borrowed in the short-term market waiting for lower long-term rates.

The potential supply of term issues therefore climbed, keeping bond rates high. On the other hand, as the effects of tight money moved us toward recession in the last half of 1981, some plans for capital expenditures were postponed or cancelled, reducing the backlog of new corporate issues. At the same time, however, corporations refinanced short-term debt with long-term bonds increasing the supply of long-term issues. Corporations are likely to continue to reliquefy, at least through the first half of 1982.

The availability of foreign sources of funds should soften demands on the U.S. bond market. Many corporations have found floating bonds in the Eurobond market to be less expensive than borrowing in the U.S. In the third quarter of last year,

issues sold in the Eurobond market easily surpassed those issued in U.S. markets—a reversal of the usual relationship.

Another source of long-term money is funds now invested in the short-term market. As rates decline in that market, funds should be recycled to higher yielding bonds. Rates could therefore trend lower in 1982.

Thus, rates on Farm Credit term issues during 1982 will probably average lower than last year. The average rate on 4-5 year bonds sold in 1981 was 14.9 percent. The average in 1982 will likely be one to two percentage points lower, and should vary among quarters with the second and fourth quarters slightly lower than the other two quarters.

Inflation—Down—The one-time changes in prices referred to as "shock" inflation, which plagued the economy in 1979 and 1980, were due mostly to rises in energy and food prices. These price rises affected all inflation indexes. The Consumer Price Index was also adversely affected by mortgage rates which continued to rise in 1981.

"Shock" inflation moderated in 1981. The increase in farm product prices slackened in world markets, as the dollar became expensive—partly in response to interest rate rises at home. Stepped-up production of petroleum in the U.S. and Saudi Arabia, plus conservation efforts and stagnant world economies, kept energy prices in check.

Barring a Mideast conflagration, stable energy prices should continue in 1982. The recent agreement among OPEC members was to hold the price of crude oil to $34 a barrel. Food prices should rise more slowly this year from the 8.2 percent of last year to about 7 percent.

The other main component of inflation, built-in or "core" inflation, arises from continuing factors. Labor costs are a major item of this component which produces a compounding effect in prices. Labor strives to look ahead by looking backward. Past inflation becomes the basis for contracts for future wages extending out to 3 years. This tends to perpetuate an inflation rate.

Contracts in the trucking, rubber, electrical equipment, automotive, and farm machinery industries are scheduled for renewal this year. These contracts will be negotiated during a sinking spell in the economy, with unemployment flirting with a 9-percent rate. At the same time, price rises have been restrained. The Consumer Price Index for the 12 months ending in September 1981 grew at an 11-percent rate, compared with 12.7 percent in the comparable prior period. Major labor contracts negotiated in 1982 should therefore show more moderate wage increases. This will provide the model for setting non-union wages. Growth in average hourly earnings should slow to about 8 percent in 1982 from 9.3 in 1981. The "core" rate of inflation is thus reduced in 1982, with a Consumer Price Index rise of about 8.4 percent—a drop of over two percentage points from last year.

Real GNP—New economic policies enacted during 1982 are expected to enhance longer term growth prospects, but the outlook for 1982 is not optimistic. For the year as a whole, real growth in GNP will be below 1 percent, but it will be on an improving trend. Thus, 1982 will be better than the decline of 0.2 percent in 1980, but worse than 1981's growth of 1.8 percent. It will be the third consecutive year that growth in output has been below the long-term trend of 3 percent. Even in 1979, growth reached no more than 3.2 percent. Our last really good year was 1978, when GNP grew by 4.8 percent. The reasons for this outlook can be seen best by examining the various GNP demand components: exports, consumer spending, capital expenditures, and Government. As indicated in the earlier section on the Federal budget, Government expenditures in the defense area will provide some business stimuli. The remaining sectors are discussed below.

Exports and Imports—The combined impact of a strong dollar and sluggish economic growth overseas caused further deterioration in the U.S.

Table 1 — Gross National Product, Current and 1972 Dollars with Change from Previous Quarter

Item	1981 I	II	III	IV,
		$ Billion		
GNP, current $[1]	2,853	2,886	2,957	2,992
Change	122	33	71	35
GNP, 1972 $[1]	1,516	1,510	1,513	1,495
Change	31	-6	3	-18

[1] Quarterly data seasonally adjusted at annual rates.

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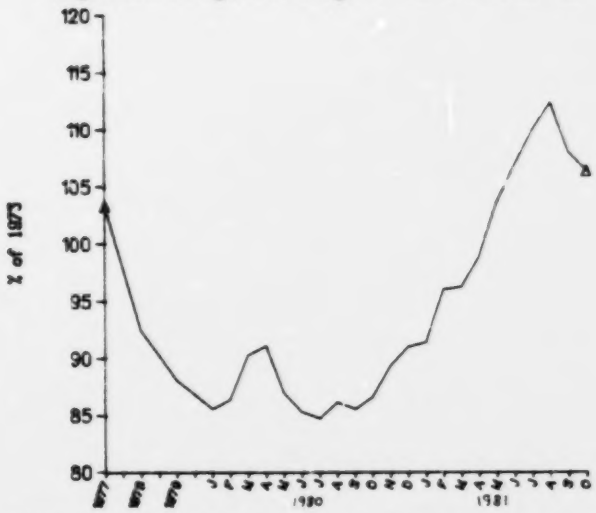
merchandise balance of payments in 1981. Following a 12.5-percent growth in the real (constant dollar) value of exports of all goods and services in 1980, a decline of nearly 1 percent was experienced in 1981. Despite reduced U.S. dependence on foreign petroleum, the real value of all imports increased by 6.5 percent in 1981, after no growth in 1980. The merchandise trade deficit in 1981 was about $30-31 billion, as compared to a $27.7-billion trade deficit in 1980.

The real value of imports is projected to grow faster than exports again in 1982, potentially adding $10 billion to the merchandise deficit. The current account balance, which includes goods, services and unilateral transfers, may shift from a surplus of $5.0 billion in 1981 to a $7 billion deficit in 1982.

The rising value of the dollar had a noticeable dampening effect on agricultural exports in the second and third quarters of calendar year 1981. Nonetheless, the level of ag exports in fiscal 1981 set a new record of approximately $43.8 billion. This contributed to a surplus in U.S. agricultural trade of about $27 billion. This surplus is expected to increase slightly in 1982.

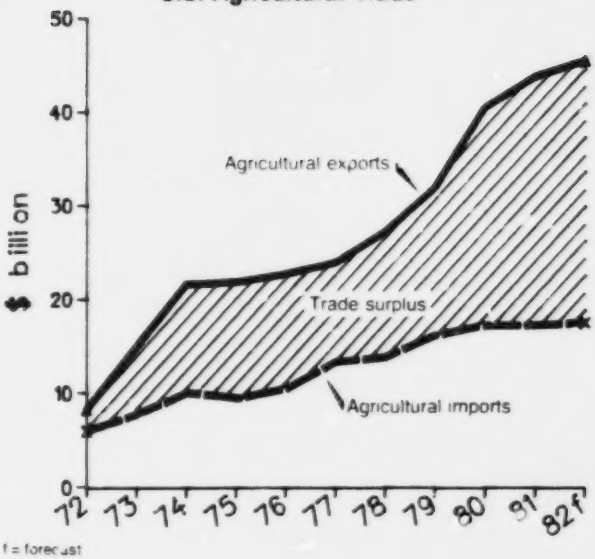
In the first 8 months of 1981, the dollar appreciated 23.5 percent in relation to the currencies of the major trading partners of the United States. As the dollar appreciates, the relative price of U.S. exports rises while the relative price of imports

Weighted Average Exchange Value of the Dollar



Trade-weighted index against currencies of major trading partners

U.S. Agricultural Trade



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declines. This encourages imports and discourages our exports. Although interest rates and the dollar reached their 1981 peaks in August, real exports will continue to decline into 1982 as the value of the dollar remains relatively firm. By the second half of 1982, the dollar will show further weakening in response to lower interest rates in the first half and because of the anticipated deterioration in the U.S. international payments position.

Also contributing to the nation's international payments problem is the lack of economic expansion in overseas countries. Industrial production in the OECD nations of Western Europe declined by 2.3 percent in 1981 and increased by only 2.2 percent in Japan. Without sustained growth in the economies of our Western allies and Japan, export demand will remain flat. Not until late 1982 are these nations expected to post minimum 4-percent growth rates.

Consumer Spending—Prospects Not Strong— Consumers have been chided many times for living beyond their means. Even when they behaved rationally and stocked up on goods in anticipation of higher prices, they were criticized. Many commentaries have carried the message that we have become a consuming and not a producing economy. They conclude that progress against inflation requires us to allocate more resources to production rather than consumption. It appears that this shift is beginning to take place and will be

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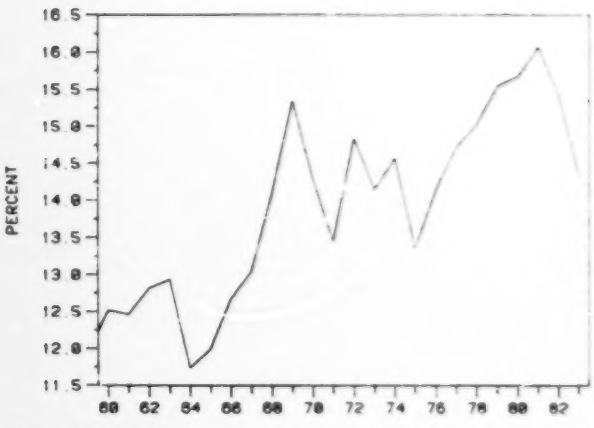
encouraged by Administration policies. While it is expected to provide a stimulus to productivity and growth in the future, it also means that consumer spending is unlikely to provide any significant stimulus to the economy in the first half of 1982.

The problem now is how to encourage equilibrium—and balance saving with spending. Besides cutting marginal income tax rates for individuals, the Economic Recovery Tax Act of 1981 provides incentives for saving through less restrictive Individual Retirement Accounts and self-employed Keogh plans. There are also newly created All-Savers Tax certificates with yields tied to Treasury Bill rates and tax exempt for up to $2,000 on a joint return. The 1982, 10-percent cut in marginal tax rates, however, is the biggest factor. The idea is to increase after-tax income to spur savings and investment. After the economy turned sour in the final quarter of last year, however, concern shifted temporarily to spending rather than saving. It is now recognized that with softness in anticipated demand, businesses will be reluctant to invest in new capital or capital improvements.

Consumer spending during the first half of the year will increase only marginally. Disposable personal income in real terms is expected to decline in the first quarter, due to layoffs and shorter workweeks. There is one stabilizing force—relatively high levels of interest income. Although it won't stave off a decline in consumer spending, it should cushion the blow and help prevent the economy from falling into a deep recession.

Personal Tax Payments As Percent of Personal Income



Source: Chase Econometrics

Table 2 — Disposable Personal Income, Current and 1972 Dollars with Change from Previous Quarter

Item	1981 I	II	III	IV
		$ Billion		
DPI, current $[1]	1,943	1,986	2,042	2,095
Change	51	38	56	53
DPI, 1972 $[1]	1,033	1,037	1,043	1,050
Change	7.5	3.5	5.8	7.5

[1] Quarterly data seasonally adjusted at annual rates

Interest income now represents 13.1 percent of personal income in nominal terms, while wages and salaries account for 61 percent. Wages and salaries will rise under 10 percent in 1982, while interest income will increase at a 12-percent rate. The third quarter should see some boosts in spending, particularly in the durable goods area—cars, housing—as the midyear tax cut takes effect.

Capital Expenditures—Corporate capital spending plans were significantly curtailed as the recession got underway in 1981. Corporations were buffeted by high interest rates, in both the short- and long-term markets, and then by weakened consumer demand. These caused postponement and cancellation of long-term projects.

Despite tax breaks from the Economic Recovery Tax Act of 1981, business capital expenditure will not pick up until the middle of 1982, when business can expect increased spending by consumers for discretionary purchases. Although spending for capital goods should accelerate in the last two quarters, plant and equipment spending in real terms is expected to decline for the year as a whole by a little over 1 percent.

Significant reallocation of resources away from a consumption economy to a savings and investment one has been delayed by the downturn of 1981-82. It is anticipated that this recession will bring about the reduction in inflation and interest rates necessary for an increase in capital investment to encourage productivity. But the possibility of resumed pressures on interest rates in 1982 from Federal deficits and a continued tight monetary policy could be a major brake on the pace of economic growth.

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III. AGRICULTURAL ECONOMIC OUTLOOK

Economic conditions in the farm sector have not been favorable during the past 2 years and near-term prospects are for little improvement. But the longer term prospects continue to be moderately favorable.

Throughout the past year, the demand for U.S. farm products suffered from a weak domestic economy, high interest rates, a strengthened U.S. dollar, and slow economic growth in our major importing countries. Even during the first half of 1981 when global crop supplies were relatively small, this weak demand condition put downward pressure on farm prices. Now, with record large domestic crop and livestock production, current supply conditions for nearly all major agricultural commodities dominate domestic and foreign demand prospects going well into 1982. With these demand pressures limiting growth in gross farm income, continual increases in production costs have meant a falling net farm income.

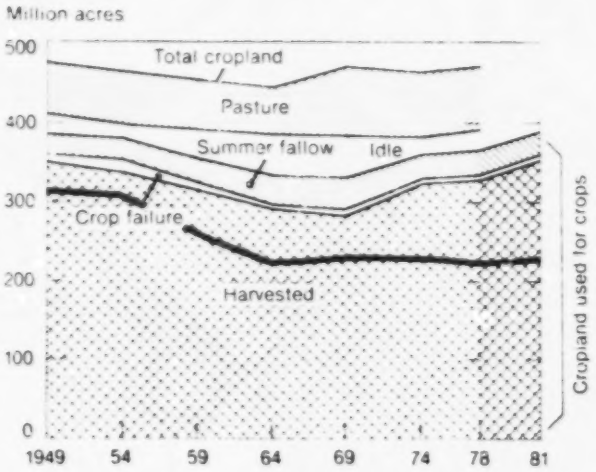
Make no mistake, fundamental supply-and-demand conditions shaping the near-term agricultural outlook are not encouraging. At the same time, bear in mind that agricultural prospects can change swiftly and that the longer run outlook is much brighter. It is important for agricultural lenders to have a balanced perspective in both good and bad times. Before being overwhelmed by forecast details, consider briefly the setting and some major factors that determine the health of the agricultural economy.

Changing fortunes in the farm sector are often associated with unexpected weather developments, either here or abroad. Our increased prominence in the world agricultural trade during the 1970s has given increased significance to global weather relative to domestic weather aberrations. At the same time, our farm sector is finding itself more closely linked and responsive to changes in the general economy through financial and other input markets. Meanwhile, the linkage through retail food markets continues to be as important as ever. Just as global weather has taken on increased importance, so has the economic strength of our trading partners. Last, but not least, farm commodity programs are headed toward a more market-oriented approach—these are discussed in the following chapters.

Only a year ago, many voices were proclaiming that the 1980s would be a decade of world food scarcity. With the U.S. having supplied much of the world's growing food needs during the 1970s, our harvested acreage having returned to previous highs, and the world need seen as ever increasing, a bright outlook seemed to assured. Recently, the popular view appears to have reversed. Rather than the world being dependent on us, we are seen as being dependent on a strong and growing world farm commodity market. Actually, the dependence is in both directions and volatile markets are an inevitable consequence.

The U.S. dependence upon exports is reflected in the large and growing proportion of our harvested acreage going toward exports. Overseas customers took the output from nearly two-fifths of our harvested acreage in 1981, compared to one-eighth in 1949, and just over one-fifth in 1969. Since 1969, the land area required to meet our domestic needs has stabilized near 230 million acres, while the crop acreage producing our farm exports has more than doubled (an increase of 77 million acres to 138 million in 1981). Much of this increase came from areas that had been idle during the 1950s and 1960s. That we have little additional acreage to bring back into production suggests that expansions in our farm exports in the 1980s will mean either (1) more direct competition between exports and domestic needs, or (2) some other types of increased economic incentive to bring some of our as yet unused cropland into production.

Major Uses of Cropland



The points plotted within the harvested area distinguish that portion going toward domestic use (lower part) versus exports. The 1981 estimates of cropland used for crops are from the USDA Outlook Conference; other components are not available. A 1977 land inventory study by USDA found that beyond the acreage in crops or idle (413 million acres) an additional 36 million acres were high potential and another 91 million were medium potential cropland. This gives rise to a potential 540 million acre base for growing crops.

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While we are learning more about the kinds of forces that influence the agricultural economy, our quantitative prediction ability has not kept pace. In fact, with more forces and greater interactions between the farm sector and other sectors of the domestic and world economies, we are undoubtedly losing ground when it comes to forecasting. The excessively optimistic forecasts for farm prices and incomes of 1 year ago can probably be attributed more to incorrect forecasting or assumptions about the U.S. and world economies than to a better-than-expected year of weather for crop and livestock production.

As discussed in the previous chapter, the United States is taking steps to achieve a sustainable economic recovery. Other governments are also attempting to control inflation and revitalize growth. Most economic projections appear to be guardedly optimistic that 1982, especially the second half, will be better in many nations. More questionable is whether the extent and speed of recovery in world economic conditions can translate into a significantly stronger demand for U.S. agricultural commodities early enough to prevent a third consecutive year of depressed farm earnings. Given relatively large stocks, conventional wisdom seems bearish. But just as the scarcity psychology of a year ago appears to have been an overreaction, the current pessimism may also be. If so, a swing toward a more balanced view could occur without a major change in the current supply/demand situation.

U.S. Agricultural Trade—A significant increase in our export volume is expected in FY 1982, but with lower prices. Value may increase only marginally to the $45-46 billion. This follows a year which also generated a relatively stable export performance (Table 3), and is in sharp contrast with the 27-percent value and 19-percent volume jumps from 1979 to 1980. While the volume and value achieved during 1981 were disappointing, they were fairly strong, given our unexpectedly high interest rates and stronger dollar combined with sluggish growth in world economies.

The 8-percent increase in value of U.S. agricultural exports during FY 1981 represented the twelfth consecutive year that a new record had been set. With our agricultural imports holding at just over $17 billion, the U.S. surplus in agricultural trade grew by 15 percent, approaching $27 billion. In a reversal of 1981 conditions, an increased value of coffee imports in 1982 will offset a lower sugar import value. The overall value of our agricultural imports should change very little and allow the agricultural trade balance to increase marginally to $28 billion.

The nonagricultural factors which adversely affected our agricultural trade in 1981 continue to be important. Slow economic growth and high interest rates constrained the ability of developing countries to buy as large a volume as they wanted and discouraged some importers from buying beyond their immediate needs. The stronger dollar made our goods more expensive in international markets, even when our domestic prices were falling steadily. U.S. farm exports were moving in line with USDA targets until the dollar's rapid rise during the spring and summer of 1981. With that appreciation, our exports deviated downward from the forecasted levels. During the current fiscal year, the value of the dollar is expected to retreat somewhat from the overvalued level during the last half of FY 1981. This should make our farm commodities more competitively priced.

An important factor in increasing our sales volume in 1982 is expanded trade with the Soviet Union.

Table 3 — U.S. Agricultural Exports: Value and Volume by Commodity, Fiscal Years 1980-1982

Commodity	1980	1981	1982[1]
		$ Billion	
Grain and feed	18.5	21.9	22.3
Oilseeds and products	10.0	9.4	9.4
Cotton, including linters	3.0	2.2	2.6
Tobacco	1.3	1.3	1.5
Fruits, nuts, and vegetables	2.7	3.1	3.3
Sugar and tropical products	0.8	1.4	1.3
Livestock and products	3.1	3.1	3.6
Dairy products	0.2	0.3	0.4
Poultry products	0.5	0.8	0.6
Total[2]	**40.5**	**43.8**	**45.5**
		Million Metric Tons[1]	
Wheat	36.1	42.2	50.0
Wheat flour	0.9	1.0	1.0
Feed grains	71.2	69.0	74.1
Rice	3.0	3.2	2.6
Other grain products	1.1	1.2	1.3
Feed and fodders	6.2	5.8	5.8
Soybeans	23.8	20.0	22.9
Soybean meal	7.2	6.1	6.7
Other oilcake and meal	0.4	0.5	0.5
Soybean oil	1.2	0.7	1.0
Other vegetable oils	0.6	0.8	0.9
Sunflower seed	1.9	1.4	1.4
Cotton, including linters	2.0	1.3	1.6
Tobacco	0.3	0.2	0.3
Fruits, nuts, and vegetables	3.0	3.2	3.6
Beef, pork, and variety meats	0.3	0.5	0.4
Poultry meat	0.3	0.4	0.4
Animal fats	1.5	1.5	1.5
Others	2.9	3.5	4.0
Total[2]	**163.9**	**162.6**	**180.0**

[1] Shown in actual export tonnages converted to product equivalents. Excludes animal numbers and some commodities reported in cases, pieces, dozens, liquid measures, etc.

[2] May not sum due to rounding.

f = forecast.

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The Soviet Union's third consecutive poor harvest in 1981 is forcing them to rely heavily on world markets to satisfy their domestic needs. Preliminary estimates are for a 43-million, metric-ton import requirement of wheat and coarse grains by the USSR this marketing year. An estimated 18-20 million tons are expected to be shipped from the U.S. As of mid-November, 10 million tons were already under contract. The estimate could potentially be scaled upward if poor weather conditions prevail in Argentina, a nation that is expected to supply the Soviet Union with 13 to 14 million tons of grain. If our sales reach an allowable 23 million tons, this would mean $3 billion in farm level sales at prices prevailing in late 1981.

One of the Administration's top priorities is to expand farm exports, particularly in the Far East, as a means of propping up U.S. grain prices. Five years ago, the U.S. market for agricultural exports to China was virtually nonexistent. In 1981, Chinese purchases of U.S. wheat were valued at $1.1 billion and cotton at $701 million. The combined markets of China, Japan, and South Korea imported $10.9 billion of U.S. agricultural commodities, making Asia by far our largest regional market. Their imports exceeded purchases made by the European Community by nearly one-fourth in fiscal 1981.

Although the U.S. is in a favorable export position due to record corn and wheat harvests and a near-record soybean crop in 1981, the nation faces an increasingly competitive world situation. In addition, we have seen increased use of trade-restricting and trade-distorting practices from some quarters—notably in the European Community. Protected by variable import levies and stimulated to produce all-out by high support prices, EC farmers have made the EC a surplus producer of nearly all agricultural products except soybeans. As a result, their surplus disposal efforts threaten U.S. shares of third-country markets, and their import policies are hurting our export sales. Last year, the EC, which is our oldest and traditionally one of our largest regional markets, took shipments valued at 8 percent below their fiscal 1980 imports.

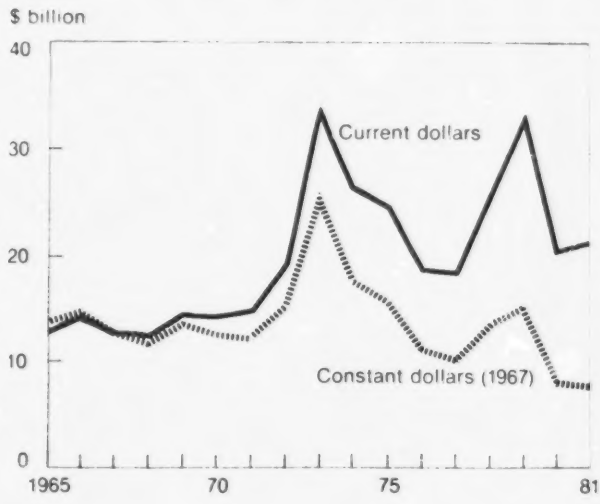
While Argentina, Australia, and South Africa produce only 5 percent of world coarse grain output, these Southern Hemisphere countries are major competitors and are key swing factors in world coarse grain trade. With limited storage, their exportable supplies move quickly to market during our spring. They typically supply 20 percent of the world's coarse grain trade—the bulk of the market beyond our two-thirds or more share. In soybeans, our main competitor, Brazil, typically markets its supplies in the March-September period.

Farm Income and Expense—For the third straight year, farmers are expected to experience serious cash flow problems, with farm receipt increases falling short of the growth in farm expenses. During 1980 and 1981, farm cash receipts increased by 3 and 5 percent, respectively, while production expenses rose an estimated 9 percent each year. USDA projections offer little encouragement, at least during the first half of 1982. Receipts are projected to increase 4 to 5 percent and production costs by 6 to 7 percent. The projected 1982 receipts reflect an expected increase in crop and livestock marketings and only a slight increase in overall prices received by farmers.

Year-ago projections of a rebound in net farm income during 1981 faded with each passing month. The overall prices received index fell during each of the first 11 months, leading to a deteriorating farm income situation and setting the stage for a rather bleak outlook going into 1982. Rather than a projected $27-32 billion net in 1981, it is expected that the figure will fall within the $20-24 billion range. The 1980 figure, which 1 year ago was estimated at $24 billion, has now been pegged at $20 billion by USDA. (All values are net farm income after inventory adjustment.)

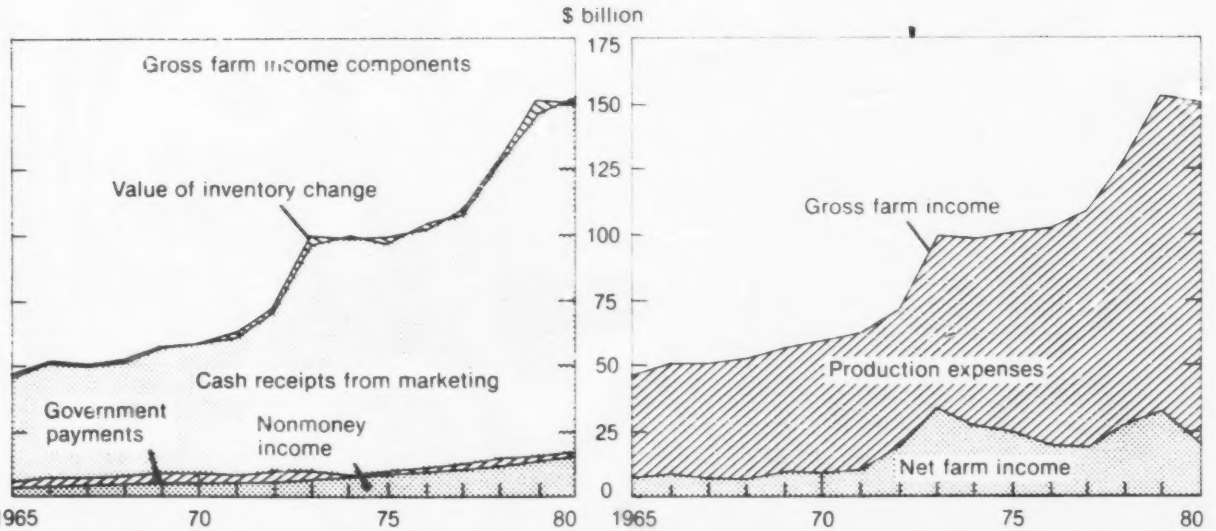
These latest nominal values for 1980 and 1981 paint a very depressed farm earnings picture—in real terms these are the lowest since the 1930s. Though declining farm numbers blunt some of the weakness in real per-farm net income, the weakness in purchasing power is being evidenced by

Net Farm Income



Net farm income includes inventory adjustment. CPI used as deflator. 1981 forecast.

Income from Farming



Net farm income includes inventory adjustment. 1981 forecast.

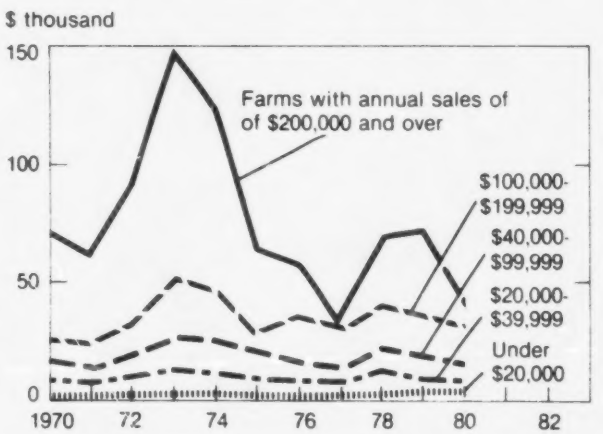
very sluggish farm machinery and farm real estate markets. Since farm earnings have a lagged effect in certain of these markets, this recent history has some negative implications for the future. But the really bad news is that the net farm income picture seems likely to worsen further during 1982.

Unless farm commodity prices strengthen, there will be a significant drop in nominal net farm income during 1982. With abundant crop and livestock supplies and weakening economic conditions, the prospects are not encouraging at least for the next several months. Three consecutive years of depressed farm income would have profound implications for the agricultural economy. High cost producers and those carrying large debts relative to their equity would be most adversely affected. Farm input suppliers and the farmland market would continue in a rough adjustment period. These implications are treated in greater detail in the agricultural finance chapter.

It should be noted that the measure known as net farm income is not the most easily understood concept. It is subject to misinterpretation. The farm sector is far from homogenous. Broad generalizations do not adequately describe economic conditions for all farmers. There are wide income variations according to commodity produced, region, size, and tenure of operators. Tenure has become especially important during the last decade, because asset appreciation has become a dominant part of the return to agricultural investment and a major source of funds through refinancing.

In evaluating the meaning of changes in nominal and real net farm income over time, one must consider the number of family units primarily dependent on the farm for income. Over a number of decades, this number has probably decreased much more rapidly than has the overall number of farms. The 1.5 million farm families having gross farm sales of under $20,000 depend on the farm for less than 10 percent of their income on average. On the other hand, for the several hundred thousand farms with gross sales of over $100,000, net

Average Net Farm Income by Sales Class



Net income before adjustment for inventory change. Beginning in 1977, farm income data reflect a change in the farm definition from a place of 10 or more acres with $50 in agricultural product sales or of under 10 acres with $250 in sales to simply a place with $1,000 in sales.

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Table 4 — Distribution of Farm Numbers and Dependency On Net Farm Income by Farm Sales Classes

Item	Year	Farms with sales ($1,000) of — $100 and over	$40 to <$100	$20 to <$40	$10 to <$20	$5 to <$10	$2.5 to <$5.0	Under $2.5	All Farms
					Percent				(thousands)
Number of farms	1960	0.6	2.3	5.7	12.5	16.7	15.6	46.6	3,963
	1970	1.9	6.1	11.1	13.2	13.6	14.3	39.8	2,949
	1980	11.6	15.8	11.6	11.8	13.7	14.5	21.0	2,428
									(average)
Dependence on net farm income[1]	1960	n.a.	88.8	82.8	80.2	67.1	51.1	22.8	56.7
	1970	84.2	81.4	75.6	58.3	37.2	21.5	10.8	44.8
	1980	72.4	67.8	46.9	25.1	13.0	7.3	8.3	28.1

[1]Percentage of family income derived from net farm income. Source: USDA, *Economic Indicators of the Farm Sector*, Statistical Bulletin No. 674, 1981. n.a. = not available.

farm income comprises nearly 75 percent of their family income. It is these larger operations that are greatly affected by the variability in net farm income. The residual return to their growing commitment of family resources must increase if these units are to remain viable.

Between 1960 and 1980, a declining percentage of farm families were dependent on farm income as a primary source of income. In 1960, more than 53 percent of all farm families on average derived more than one-half their income from farming. By 1980, this percentage had declined steadily to 27.4 percent.

Farmers with sales of less than $40,000, in particular, have become increasingly dependent on other sources of income. Back in 1960, all but smallest sale class averaged more than 50 percent of family income from farm sales. One must exercise caution in drawing conclusions from this sales class data, because the effects of inflation and the nature of these fixed sales classes would automatically generate much of what appears as trends, even if there was little change in real terms for most farm units. It does appear though that there has been a significant downward shift in the relative dependence on farming as an income source among farm families.

As farms have become more specialized over time, the aggregate measures for the sector are becoming less descriptive of any particular group of producers. The farm income accounts do not provide net return estimates by type of farm or major producer group. But they do provide a means, through studying changes in cash receipts for individual commodities, for evaluating the changing fortunes of major producer groups. Table 5 provides cash receipts estimates and forecasts for 1979-1982, as presented by USDA at the National Outlook Conference. These figures suggest that much of the decline in net farm income in 1980 and 1981 was felt by the livestock sector and by those crop producers hit by drought. In the year ahead, livestock receipts are expected to gain slightly relative to crops receipts.

Table 5 — Cash Receipts from Marketings: Values for Selected Commodities, Calendar Years 1979-1982

Item	1979	1980	1981$_p$	1982$_f$
		$ Billion		
Crops:[1]				
Wheat	7.8	9.0	9.9	10.1
Rice	1.2	1.5	1.9	1.9
Corn	10.3	12.9	12.9	13.8
Soybeans	13.0	13.4	13.3	14.3
Tobacco	2.3	2.7	3.2	3.2
Fruits	6.4	6.5	6.8	7.2
Vegetables	6.6	6.8	7.9	7.7
Subtotal[2]	**63.4**	**69.0**	**73.7**	**76.7**
Livestock:				
Cattle/Calves	34.4	31.2	30.4	33.2
Hogs	9.0	8.9	9.8	10.0
Broilers	4.2	4.4	4.7	5.1
Turkeys	1.4	1.5	1.4	1.3
Eggs	3.3	3.2	3.5	3.6
Dairy	14.7	16.6	18.0	18.3
Subtotal[2]	**68.5**	**67.4**	**69.8**	**73.5**
Total	**131.9**	**136.4**	**143.5**	**150.2**

[1]Crop receipts include the value of Commodity Credit Corporation loans.

[2]Subtotals include other crop and livestock items not shown.

p = preliminary. f = forecast.

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On a deflated (constant dollar) basis, the current cash receipt situation is not as bleak as one might think, compared to the 1974-1980 period. While the overall cash receipt series has been weakening for several years and 1981 will match the recent low of 1977, the 1981 and 1982 levels for nearly all major commodities will be no lower than individual low points between 1975 and 1978. The only notable exception is for hogs.

It should also be recognized that there is a fairly large forecast error associated with the 1982 cash receipt projections. To illustrate how sensitive farm cash receipts are to changes in farm commodity prices, note that to generate (or for that matter lose) $1 billion of cash receipts requires: for soybeans 50¢/bu; corn 20¢/bu; wheat 40¢/bu; and cotton about 17¢/lb. On the livestock side, for beef cattle it is about $2/cwt; hogs $4.25/cwt; and broilers about 6¢/lb. For many of these major commodities, the projected 1981/82 price ranges presented during USDA's November conference exceeded these changes. Further, several of these commodity prices tend to move together; so a swing in a group of prices can add to cash receipts rather quickly.

Inputs—Price increases for almost all nonfarm purchased inputs are expected to moderate next year. Farm input prices stabilized during the latter months of 1981, due to sluggish demand in both the farm and nonfarm sectors. By late 1981, the index of prices paid by farmers for production items was 5 percent above a year earlier. The greatest upward pressure on production expenses in 1981 was from record-high interest rates on a growing farm debt. It is expected that interest charges will continue to be an important component of production costs during 1982.

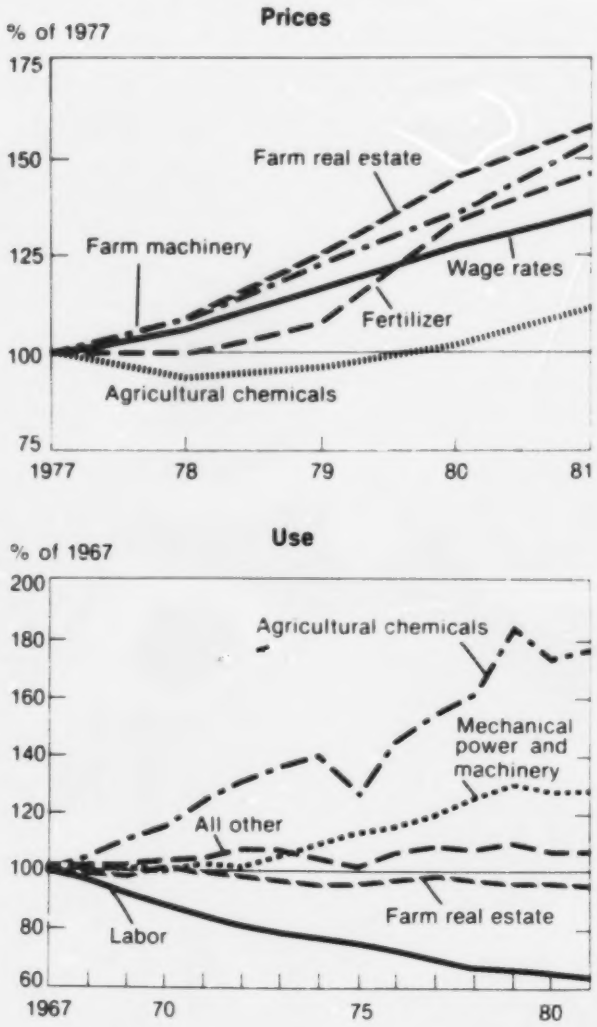
Farm origin inputs such as feed, purchased livestock, and seed make up about one-fourth of total production expenses. These have had moderate increases during the past 2 years. For 1982, the feed component is expected to hold steady, but feeder livestock outlays are expected to increase significantly.

Stabilizing prices for fuels and energy have had a large effect on slowing the growth rate in farm production expenses. With energy prices slowing their rise, fertilizer costs have moderated in 1981 and should slow further in 1982. Some reduction in planted acreage is expected if the price outlook for farm commodities does not strengthen during the first half of 1982.

USDA has estimated that total interest costs in 1981 reached about $19 billion. This is a 20-percent jump from 1981, and accounts for about 13 percent of total production expenses. The average interest rate on all outstanding farm debt rose to 10.1 percent in 1981 from 9.5 percent in 1980. (Most new borrowing was, of course, at much higher rates.) For highly leveraged producers, interest is a much more dominant cost element. With a farm debt currently near $200 billion, a 1-percent change in the overall interest rate faced by farmers means about a $2-billion difference in farm production expenses over the course of a year.

Food Prices—Generally plentiful supplies of agricultural products are expected to exert a moderating influence on retail prices in 1982.

Selected Farm Inputs



Farm machinery includes tractors and self-propelled machinery. 1980 preliminary, 1981 projected.

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Table 6 — Retail Food Price Percentage Changes, 1979 to 1982

Food Category	1979	1980	1981f	1982f
		Percent Change		
All Food	10.9	8.6	8.2	7
Food away from home	11.2	9.9	9.3	8
Food at home	10.8	8.0	7.8	6
Cereals and bakery products	10.1	11.9	10.2	7-8
Beef and veal	27.3	5.7	1.8	5-7
Pork	1.5	-3.4	9.8	8-11
Other meats	14.7	3.8	5.0	6-7
Poultry	5.0	5.1	5.5	3-5
Fish and seafood	9.8	9.2	8.9	8-9
Eggs	9.5	-1.8	7.8	4-5
Dairy products	11.6	9.8	7.5	4-5
Fresh fruits	12.4	6.2	5.3	8-9
Fresh vegetables	2.9	8.9	20.1	-1-0
Processed fruits and vegetables	8.6	7.0	12.2	9-10
Sugar and sweets	7.8	22.9	8.2	2-3
Fats and oils	8.0	6.6	11.5	5-6
Nonalcoholic beverages	5.0	10.6	4.1	2-3
Other prepared foods	10.1	10.8	10.5	9-10

Based on the Consumer Price Indices, All Urban Consumers. Sources of historical data, Bureau of Labor Statistics. f = forecast, made by USDA

USDA's forecasted range of price increases for food purchased at retail is 5-9 percent over the 1981 average. This represents a reduction in the pace of food price inflation experienced during the past few years. It is also less than the 8-10 percent increase in the general Consumer Price Index, which many observers expect during 1982.

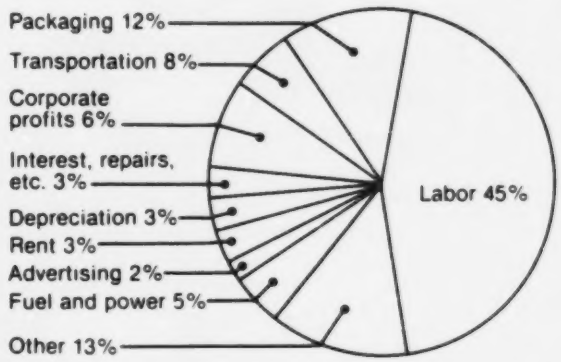
The price of food purchased at retail, either from grocery stores for home preparation or as prepared food mainly consumed outside the home, is influenced by (1) the price and quantity of raw agricultural products, (2) the cost of marketing and food preparation activities required before the agricultural product can be purchased as a retail food item and (3) the purchasing power of consumers.

Record grain production in 1981 is a key factor in constraining the influence of the farm-level component during 1982. This moderating influence will be felt both for cereals and bakery products and for animal products. Increased meat production will be induced by lower feed costs. Large supplies of beef, poultry, and dairy products will moderate price increases for these products to the single-digit range, stimulating greater per-capita consumption. Pork production, in contrast, will likely decline in 1982. This development may result in pork product price increases higher than for any other major category of farm products.

Marketing costs are more important in retail food prices than most consumers realize—about two-thirds of final retail food prices. These costs moderate the price effect of more visible farm product supply-and-demand shifts. Anticipated increases of 8-10 percent in food marketing costs are a major factor in explaining general food price inflation for 1982. Transportation costs and higher retail employee wage rates will play an instrumental role. Considerable uncertainty, however, surrounds the labor cost component, with the many union wage contracts scheduled for negotiation during 1982.

The recession will weaken consumer's real income during early 1982, so demand determinants may have little influence on retail food prices for the year as a whole—softening effects initially balanced by strengthening ones later. Large food supplies and more moderate price increases in 1982 should encourage greater domestic food consumption for the year. But strength in real disposable income is required before the away-from-home food service industry would capture a greater share of this increased food consumption. This is not likely to occur until the latter part of 1982. Consumers simply will not have the purchasing power early in the year to support higher expenditures for food away from home. The tax reduction scheduled for July 1 will help to restore, or at least help to maintain consumer purchasing power.

Components of the Farm-Food Marketing Bill



Based on foods marketed through foodstores as well as away-from-home eating places. Other includes promotions, professional services, property taxes, local hired transportation, and insurance. Preliminary 1980 data.

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IV. 1981 FARM AND TAX LEGISLATION

1981 Tax Act

The 1981 Tax Act will have far-reaching impacts on farmers. The rate cuts, incentives for retirement savings, and the changes in estate/gift taxes are of major significance.

Cuts in personal tax rates will affect farmers in the same way as they affect nonfarm households and businesses. But the direct effects on farmers will be small in 1982, and will remain small as long as farm income stays low. Thus, initial effects of the rate cuts will be primarily indirect; however, the benefits will increase in the long term, when farm income improves.

As businessmen, farmers may also gain from the increases in depreciation deductions. But these gains should be small during the coming year on all investments made in 1981 and after for two reasons. First, low farm income and high interest rates should continue to deter investments in buildings and equipment. Second, equipment purchases above $5,000 and below $20,000 per year were made only slightly more attractive by the Act, because it repeals the "bonus" first year depreciation of 20 percent. In addition, the reduction in useful life for tax purposes (now called "recovery period") is less meaningful when low income keeps farmers in low tax brackets in the first place. During the next year, the main impact may be that unrelated nonfarm investors will become a source of equity capital for equipment and buildings, via leases. Over the longer term, the shorter service life for buildings and the eligibility of specialized livestock facilities for the full 10 percent investment tax credit may encourage investment in these facilities.

The 1981 Tax Act may slow the trend toward incorporation of farms and ranches, by reducing at least two advantages contained in earlier tax law. The 1978 Act cut corporate rates to a greater degree than individual rates. It also allowed greater accumulations for retirement savings. The 1981 Act removed these incentives for incorporation by cutting personal rates, by making Individual Retirement Accounts (IRAs) available to all taxpayers and by raising the ceiling for Keogh plans. However, farm lenders will still need to understand complex business organizations, and farmers may have other reasons for adopting them.

One minor provision of the Act may encourage incorporation of farms. The gift-tax exemption was raised from $3,000 to $10,000 per year, per recipient. For example, a couple can give $20,000 per year to each child, tax free. Giving shares in a family corporation is much more convenient than deeding a few acres each year.

While the direct impacts of the Tax Act on farmers may be small in 1981, the indirect effects could be large. The depreciation rules allow unprofitable businesses to "sell" their depreciation and tax credits (via leasing) to profitable, tax-paying firms. For example, Ford Motor sold tax benefits to IBM for more than $100 million. Shorter recovery periods for the costs of capital items should also spur business investment generally. Both provisions will raise borrowing by business. The huge personal tax cuts will reduce the Treasury's tax revenues and force it to increase its borrowings. Meanwhile, the 1981 Act did nothing to stop individual taxpayers from deducting personal interest and property tax payments. As a result, individuals who are in high tax brackets still have a strong incentive to borrow. Now they are being joined by expanded demand from business and the U.S. Treasury. As all three sectors compete for money that remains tight, interest rates will remain under upward pressure. Only if business investment raises economic growth and savings sufficiently, or if rather large amounts of savings are encouraged by other provisions of the new law, will the Tax Act cause interest rates to fall. Increased competition for funds is likely to outpace larger savings, thus keeping interest rates relatively high, despite the recession. In addition, high interest rates in the general economy will continue to be passed along quickly to farmers.

Changes in estate and gift taxes, phased in over the next 5 years, more than offset the decrease in the real value of the estate and gift tax exemptions since the 1976 Tax Act. Estates of $600,000 will be exempt from tax in 1987, compared to $225,000 in 1982. In addition, qualifying property passing to a surviving spouse will be exempted completely. Further, the special "farm use" valuation of property, which may cut gross value of an estate in half, was raised from a $600,000 limit in 1981 to $750,000 in 1983 and after, and was broadened in several aspects. These changes will make estate taxes less crucial for smaller estates, and

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they may encourage holding of farms within the family between generations. If so, we may see fewer voluntary sales of land.

Thus, estate tax changes may affect the type of farm mortgage financing market, as well as the estate planning services offered by Farm Credit banks. *De facto,* they may increase outside equity in the farm sector: a "tax trap" encourages heirs who have left the farm to retain their ownership for years after an estate is created. Such a change increases the entry barrier to owner-operator farming for individuals without such family ties and, at the same time, it enhances the attractiveness of intergenerational succession. Under the new tax law, land sales contracts may carry interest rates as low as 6 percent, a factor which may encourage the use of seller financing, especially among family members. By charging a lower interest rate and a higher price, the seller pays more of the tax at capital gains rates and less at current rates on interest income.

Farm Bill—1981

Legislation establishing the framework for 1982-86 farm programs will generally continue the course established during the 1970s. But differences among the Senate bill, the House bill, and the Admininstration were still being resolved in conference committee at the time this Outlook was assembled. These differences centered on (1) the amount of Federal budget exposure in 1983 and 1984; (2) the type of programs for sugar and peanuts; and (3) the amount of flexibility or discretion to be given to the Secretary of Agriculture in fine-tuning programs each year. Final resolutions will be provided as an insert to this report, if these become available prior to our distribution.

The 1981 debate has been over refining a set of programs which worked reasonably well in the 1970s to meet the challenges of the 1980s. These programs rest on a common set of assumptions, characterized by one Outlook speaker as:

1. Yield and productivity will continue to increase.
2. World demand for U.S. output will grow.
3. Commodity prices adjusted for productivity gains are likely to increase over the long run, at least as fast as production costs.
4. Government programs should include:
   a. Orientation toward the market with loan rate supports set at levels which will not interfere with market functioning;
   b. Safety net provisions—target prices, set-asides, and deficiency payments—that dampen some of the great instability inherent in agriculture; and
   c. Commodity reserve programs which moderate price fluctuations between good and bad years.

One of the challenges in designing new legislation is to have a program that is adaptable in event any of these assumptions should prove wrong.

The Administration has expressed strong preference for the Senate approach, because of flexibility and budget implications; however, there is no assurance that Congress will agree nor that the President would sign a compromise. In the event of a veto, most programs would revert to provisions of 1949 legislation. These would likely prove unacceptable and force further legislative activity. Major details of the Senate and House versions are covered in the Commodity Outlook Chapter.

Several longer term issues will likely be considered in farm policy discussions during the 1980s, apart from the 1981 commodity legislation. These include:

— Should U.S. produce for maximum exports?

— Should there be Government policy on how many persons should be involved as farmers? family farm policy?

— How can soil and water be managed with proper consideration to our long-term interests?

— How will better understanding of nutrition and health affect agriculture?

— What roles should agriculture play in the production and consumption of energy?

— How should policy handle interruptions due to embargoes?

— When we have short supplies, how do we balance the interests of farm and nonfarm sectors?

— How much public support should go toward increasing agricultural productivity?

— What should be the goals and the pace toward reducing export barriers?

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V.—AGRICULTURAL FINANCE OUTLOOK

Creditworthiness will be more of a concern than credit availability in 1982. Poor farm income prospects on the heels of two disappointing years will compel careful financial planning and diligent attention to loan servicing. The drop in real wealth during the past 2 years is a vivid reminder that capital gains on farmland cannot be taken for granted.

Though the general financial health of farmers remains satisfactory, the margin of safety has been reduced. All farmers are expected to borrow conservatively, giving special attention to postponing items which can be delayed. Because the basic problem is cost increases, cost control will be essential. Borrowers who went into the last 3 years in a highly leveraged position, or who suffered a sequence of drought years or other disaster, will need careful financial planning in order to survive. Some will need to liquidate a portion of their assets.

No widespread distress selling or foreclosure is expected. The vast bulk of loans remains in satisfactory condition. But extensions and reamortizations are expected to rise from the relatively minimal levels experienced in 1981.

Planning for 1982 requires one to recognize individual financial risks, which vary widely among borrowers, and to consider carefully the use of the "safety net" offered by Government programs. Though the protection is less encompassing than formerly, it still includes commodity price supports, Federal all-risk crop insurance, and disaster loans. These are important tools in building a prudent financial plan for 1982. Though the longer term suggests more optimistic income prospects, the focus in 1982 will be directed more at consolidation than growth. If demand conditions improve in the second half, this focus may start to shift.

Cash Flows—Net cash flow provides an important measure of the capacity of the agricultural sector to meet existing debt service obligations and to assume additional debt. It is a measure of the cash available for living expenses, debt servicing, and farm or off-farm investments. The components are indicated in Table 7.

Cash flow thus affects both old and new borrowing. Weakened capacity to retire existing debt is a topic of vital concern to lenders. Ability and willingness to acquire new debt is derived from farmers' demand for other inputs. As cash flow positions strengthen, demand expands from nonpostponable items, such as seeds, pesticides and fertilizers, to capital goods items. Conversely, weakening cash flow positions are an indicator of weakening demand for capital intensive and postponable purchases such as machinery, equipment, and land.

Net cash flow of the farm sector dropped in 1980 and again in 1981 from the strong position which distinguished 1979. The weakened cash flow has come, ironically, when cash receipts from farm product marketings have never been higher. While gross farm receipts have increased, the cost of inputs employed by farmers have increased at an even faster pace.

The "squeeze" on cash flow, while justifiably raising considerable concern for the financial health of agriculture, has not yet resulted in a significant increase in the rate of either loan defaults or delinquencies. But the quality of the loans in the

Table 7 — U.S. Farm Sector Cash Flow, 1979-1981[1]

Item	1979	1980	1981[f]
		$ Billion	
Cash Receipts			
Crops	63.4	69.0	74
Livestock	68.5	67.4	70
Total	**131.9**	**136.4**	**144**
Government Payments	1.4	1.3	2
Other Cash Income	2.1	2.2	2
Total	**135.4**	**139.9**	**148**
Cash Expenses	97.8	106.9	117
Net Cash Farm Income	37.6	33.0	31
Change in Loans			
Real Estate	10.9	8.6	10
Other	10.0	7.1	8
Change in Currency	0.1	0.1	0
Rent Income	6.1	6.6	7
Total	**64.7**	**55.4**	**56**
Capital Expenditures	19.9	18.4	18
Net Cash Flow	44.8	37.0	38

[1]Excludes farm households, but includes net CCC Loans in crop receipts.
f = forecast

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portfolio has suffered some decrease and some loans will require increased servicing attention.

Outlook for Cash Flow—Prospects in 1982 do not suggest any major improvements are near. Dramatic increases in cash receipts on the order of those occurring in 1972/73 or even 1978/79 are not likely. While some moderation in the pace of inflation is likely during 1982, the price farmers pay for inputs will be a major contributor to a continued weak cash flow position. It is expected that 1982 will be the third consecutive year marked by weakened ability to meet debt service obligations. The cumulative effect may be sufficient to cause some increase in either delinquencies or defaults. Others will need to make adjustments including refinancing debt to reduce annual payments, taking nonfarm employment, or selling off some of their assets. For the vast majority, however, 1982 will be accommodated without such major steps. Creditors will need to devote additional attention when working with borrowers to maintain credit standards, thus ensuring that loan quality continued at satisfactory levels and helping borrowers maintain viable operations through this difficult period.

Farm Machinery Demand—The expected continuation of weak cash flow will mean further postponement of capital goods purchases for many farmers. Machinery and equipment demand will continue to be sluggish, despite some increase in replacement demand pressure resulting from purchase deferrals in previous years. More favorable treatment of capital asset depreciation by the new tax code, while a positive influence, cannot fully compensate for a diminished capacity to pay.

Land Markets—Land purchases are made in response to a somewhat different set of economic variables. While short-run cash flow is always a consideration in the decision to purchase real property, the cash flow position of agriculture is less crucial. Many offerings become once-in-a lifetime opportunities for other farmers to expand or consolidate with their existing operations. Only a small number of tracts are offered in any one year, so that only a few financially healthy buyers are required to support the overall market. While the reduced cash flow position will mean fewer eligible or interested bidders, the unique opportunity represented by each sale will be a strengthening force.

Demand will also be supported by some conversion of agricultural land to residential or commercial uses, as both residential and commercial construction respond to lower interest rates. Another strength is in land with associated mineral rights in petroleum, coal, or even water. Further strength could develop as the returns to money market investments become less attractive and the cost of owning land becomes lower.

With some history as an appreciating asset, land purchase is an investment alternative that has increased in attractiveness to both farmers and nonfarmers. Any increases in farm commodity prices that improves short-run cash flow would compound the stimulus from falling interest rates. On the other hand, land turnover could also be stimulated by recent weakening of land prices, which have made better investment alternatives available, and by an increasing willingness to sell by owners who need to correct an illiquid financial situation. Undoubtedly, the number of properties offered for sale to relieve financial distress will increase in some areas. Considering these various factors, the prospect for land price increases is less certain now than in any other year during the past decade.

Farm Balance Sheet—A second important measure of financial well-being is the balance sheet position. This measure has always been extremely strong for the farming sector. Some moderate weakening is ensured in 1981. Within the sector, individual farmers span a broad spectrum, with much of the debt concentrated on the larger farms.

Table 8 — Nominal Changes in Balance Sheet of Farm Sector During Calendar Years 1979-1981

Item	1979	1980	1981
		$ Billion	
Assets			
Real estate	101.1	72.5	66.3
Livestock and poultry	10.1	-0.5	2.1
Machinery and motor vehicles	11.6	5.6	7.2
Crops stored	5.5	2.9	6.4
Household equip	1.4	2.6	1.7
Financial assets	1.8	2.8	2.6
Total	**131.5**	**85.9**	**86.2**
Liabilities			
Real estate debt	11.9	9.3	11.4
Nonreal estate debt	9.9	7.4	8.5
Total	**21.8**	**16.7**	**19.9**
Equity	109.7	69.2	66.4

Assets—On January 1, 1982, the dollar value of farm assets is expected to be $1,176.5 billion, $86.2 billion, or 7.9 percent higher than the same date in 1981. The general price level, however, will have increased by more than 9 percent over the same period. As a result, the purchasing power of farm assets will have declined by $11.9 billion, a 1-percent decline for the year.

The decline in the real value of farm assets in broadly based. It includes farm real estate, -0.9 percent; livestock and poultry, -0.5 percent; machinery and motor vehicles, -1.8 percent; household equipment and furnishings, -1.3 percent; and financial assets, -2.3 percent. Only crop inventories, which rebounded in volume, escaped the decline in 1981. For all of 1981, the purchasing power of crops stored on and off farms increased by about 7.8 percent over the year-earlier level.

Because they dominate the asset side of the farm sector balance sheet, changes in land values are especially important to the financial health of American agriculture. Historically, unrealized appreciation in land has been a primary source of the increased capacity of the farm sector to carry debt.

After 2 years of weakened net income and cash flow, farm real estate markets have turned sluggish. This was reflected a year ago in the reduced rate of land turnover, a pattern that probably continued in 1981. Reported land values continue to increase, but at rates substantially below those of earlier years. Nominal land price increases averaged 13 percent during the 1970s, but increased by only 9 percent in the year ending February 1, 1981. Midyear estimates of nominal land prices indicated that increases of 7 to 11 percent were in order for the year ending February 1, 1982. Further declines in farm income and continued high interest rates during the second half suggest that these estimates may prove optimistic for nominal land prices.

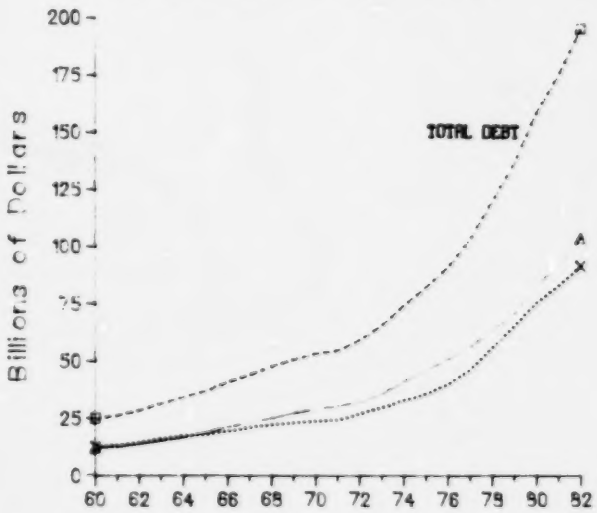
As with residential real estate values, reported farm real estate prices may be overstating the effective selling price of some land. Divergence in reported and effective real estate prices is due primarily to financing concessions by sellers. Seller-financed land transfers are an important source for farm land purchases and this offers potential for differences in reported and effective nominal land prices. Current data are not available on changes in interest rates or other concessions on contract sales.

Failure of reported land prices to keep pace with inflation caused real land values to decline by 2 percent in 1980. Although inflation subsided during 1981, increases in nominal land prices slowed even more. Continued low farm income and high interest rates will probably make 1982 the third consecutive year of decline in the real purchasing power of farm real estate—the first 3-year decline since 1931-1933. The severity of the current decline in real land prices, however, is expected to be much less than that of 50 years ago.

Farm Debt—Total farm debt is projected to have increased by $20 billion in 1981, an 11-percent gain from the preceding year, to just over $194 billion. Total debt outstanding continues to be fairly evenly distributed between real estate (53 percent) and nonreal estate (47 percent). The pace of new debt assumption is expected to remain about the same in 1982. If this expectation becomes a reality, total debt outstanding in the agricultural sector could easily exceed $200 billion by mid-1982.

Real Estate Lending—Federal land bank lending continued to play a dominant role in the farm real estate market during 1981. This market includes the financing of farm real estate transactions as well as the refinancing of existing debt. By the end of the year, the 12 Federal land banks held 42 percent of all debt secured by farm real estate.

Farm Debt Outstanding January 1



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Perhaps a more telling indicator of the FLB role is in the share of the market served over the year. During 1981, about two-thirds of the net increase in farm real estate debt was provided by Federal land bank associations—about half of this was through refinancing. Individuals and others, long the most important source and still the leader in financing actual farmland transfers, provided 15 percent of the net increase—ending the year with about 28 percent of the outstandings. Much of the seller financing is connected with voluntary sales, which were at a low level during the year. Insurance companies were largely inactive because they had little cash flow to invest, and most available funds went into nonfarm investments. This is a recurrent pattern during tight money periods. Their end-of-year share of outstandings dropped slightly to 13 percent. Because the volume of repayments exceeded new debt incurred, commercial banks actually reduced the amount of outstanding farm real estate debt held by them in 1981. However, banks are primarily short-term lenders, and much of their lending in this area may take real estate security against loans for shorter term purposes. In addition, interest rate differences and liquidity measures further discouraged mortgage lending in 1981. USDA's Farmers Home Administration provided a slightly lower share of the growth in mortgage debt, often at concessional interest rates.

Real Estate Lender's Share of the Annual Change in Outstandings

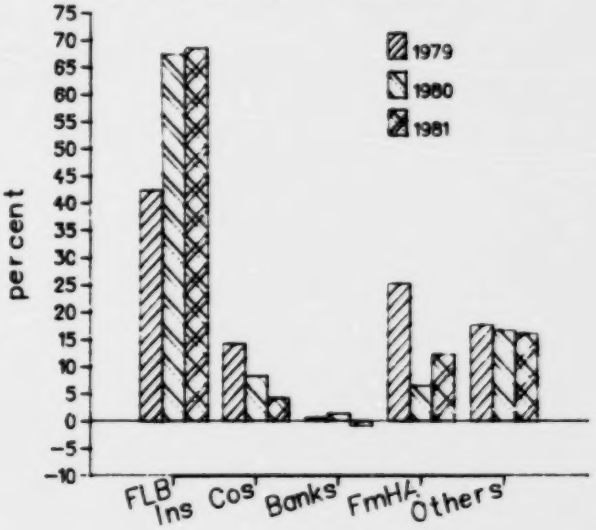

Table 9 — Farm Debt Outstanding and Market Shares by Lender, Real Estate and Nonreal Estate Lending to the Farm Sector, January 1, 1971, 1980-1982

Lender	Amount of Outstanding Loans on January 1				Share of Outstanding Loans on January 1			
	1971	1980	1981	1982	1971	1980	1981	1982
	$ Billion				*Percent*			
Real Estate								
Individuals and Others	11.4	25.1	26.7	28.5	37.5	30.4	29.0	28
FLB	7.1	29.6	35.9	43.7	23.5	35.9	39.1	42
Life Insurance Companies	5.6	12.2	12.9	13.4	18.5	14.7	14.0	13
All Operating Banks	3.8	8.6	8.7	8.7	12.4	10.4	9.5	8
Farmers Home Administration	2.4	7.1	7.7	9.1	8.0	8.6	8.4	9
	30.3	**82.7**	**92.0**	**103.4**	**100.0**	**100.0**	**100.0**	**100**
Nonreal Estate								
All Operating Banks	11.1	31.0	31.6	33.1	46.0	41.3	38.2	36
PCA	5.3	18.3	20.0	22.5	21.9	24.4	24.3	25
FICB-OFI[1]	0.2	0.7	0.8	1.0	0.9	0.9	1.0	1
FmHA	0.8	9.0	11.8	13.8	3.3	11.9	14.2	15
CCC[2]	1.9	4.5	4.4	5.7	7.8	6.0	5.3	6
Individuals and Others[3]	4.8	11.7	14.0	15.0	20.1	15.6	17.0	17
	24.1	**75.2**	**82.6**	**91.1**	**100.0**	**100.0**	**100.0**	**100**

[1]FICB discounts to eligible institutions other than PCA's. About ⅔ are affiliated with commercial banks.

[2]Includes price support and storage facility loans.

[3]Includes SBA loans estimated at $2.4 billion and $2.6 billion on January 1, 1980 and 1981, as of October 1, 1981. SBA outstandings were $3.1 billion.

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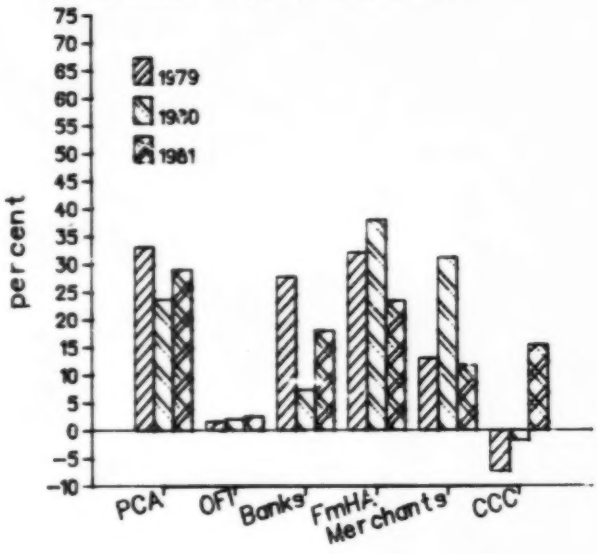
Weak net farm income in 1982, together with only small reductions in mortgage interest rates, will restrain demand for new loans secured by real property. However, higher nominal prices per acre will continue to support increased dollar volume of lending. Increases in the use of refinancing to stretch debt maturity can be expected to contribute to this growth. But refinancing to take advantage of lower long-term relative to short-term interest rates should be less. The interest yield curve has regained a normal upward slope.

Nonreal Estate Lending—Nonreal estate debt outstanding increased in 1981 by about 10 percent to approximately $91 billion.

At the end of 1981, commercial banks continued as the primary source of nonreal estate debt, with 36.3 percent of the volume. PCA share stayed nearly constant, ending at just under 25 percent. FmHA showed the largest percentage increase and held nearly 15 percent of the outstandings, despite the changed policy emphasis of the new Administration.

All the major lender groups experienced net increases in outstandings: Banks (+ $1.5 billion), FmHA (+ $2.0 billion), and PCAs (+ $2.5 billion) provided the bulk of the increase. Commercial banks recovered substantially from practically no growth during 1980, but their increase in commitments did not match the overall growth of the farm loan market. This pattern reflects the continued integration of smaller rural banks, which

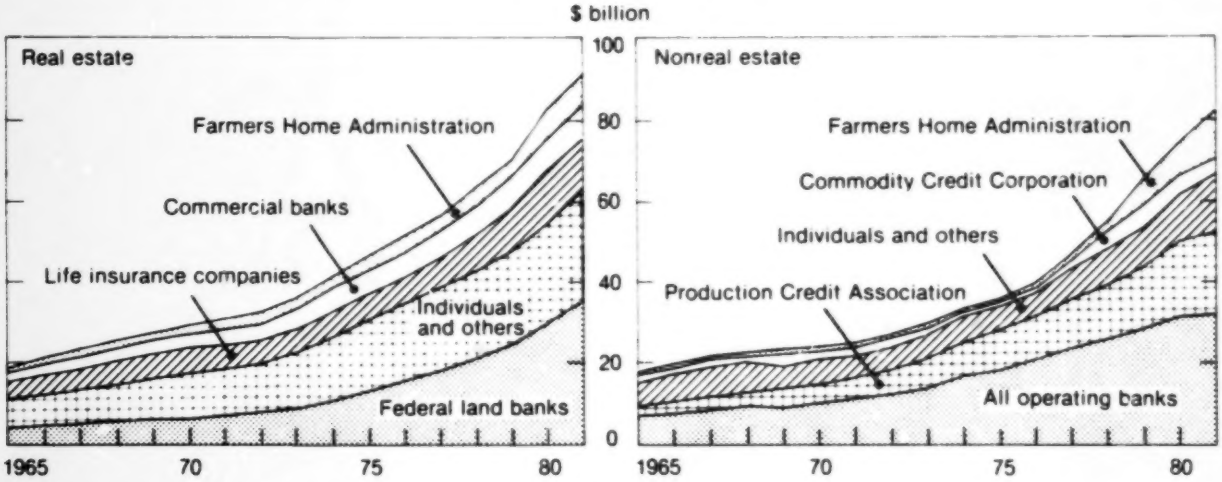
Nonreal Estate Lender's Share of the Annual Change in Outstandings



do most of the farm lending, into the national money market. During the 1970s, they lost characteristics which had insulated them from monetary policy pressures, and which formerly enabled them to carry the lowest interest rates on agricultural loans.

Low commodity prices over the year stimulated substantially greater lending activity by the Commodity Credit Corporation, as producers sought to take advantage of Government price-support programs. Credit for agricultural inputs extended

Who Holds the Farm Debt



Production Credit Association includes Federal intermediate credit bank loans to other financial institutions. 1981 preliminary

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by dealers formed a smaller share of the increase in outstanding debt during 1981, despite widespread offerings of concessionary credit terms by machinery dealers. In large measure, this development is a reflection of the decision by many farmers caught in a cash-flow "squeeze" to defer the purchase of many postponable items. Farm machinery and equipment sales, and the credit extended by dealers to finance such purchases, were dramatically affected by sagging net farm incomes and high interest rates.

The growth in FmHA lending reflected disaster loans due to poor growing conditions in 1980. Largely favorable conditions, however, did reduce FmHA lending volume under its economic emergency loan program. Lending volume under these programs may drop further should the USDA-subsidized crop insurance program grow as anticipated and the authorities under these FmHA programs be cut. Other initiatives of the Administration to tighten lending standards and to reduce interest incentives more narrowly focused the role for FmHA. This will likely decrease the share of farm finance it provides, and it will mean somewhat less of a safety net for farmers and commercial lenders.

Net Worth—Equity in farm assets rose by over $66 billion in 1981, a 7-percent increase. The debt-to-asset ratio increased to 16.5 from 16.0 percent. This ratio is a basic indicator of the financial condition of the farm sector.

The debt-to-asset ratio shows the relative importance of debt in financing the farm sector and, to some extent, the capacity to assume additional debt. Because of the risk involved in farm operations, both in prices and quantity produced, farmers generally prefer to hold debt to a minimum so that they can survive in bad years and be in a position to recover when prosperity returns. Thus, in prosperous times, the farm sector's debt-to-asset ratio tends to decline as loans taken out in lean years are paid off and the value of assets appreciates.

During and soon after World War II, for example, the farm sector's debt-to-asset ratio declined dramatically. In 1940, farmers owed almost 19¢ for every dollar of assets held. By 1947, they owed only a little over 7¢ for every dollar of assets. The production adjustment problems of the 1950s and 1960s forced the ratio to a post-war high of 16.8 percent by the early 1970s. More prosperous years during the 1970s brought the debt-to-asset ratio down. Poor economic conditions in agriculture caused the ratio to rise to 15.7 by January 1980, to 16.0 by January 1981, and to an estimated 16.5 by January 1, 1982. Barring an unforeseen turnaround, further deterioration can be expected in 1982. If farm assets and debt increase in 1982 by the same percentages that they did in 1981, the debt-to-asset ratio will rise to 17.1, its highest level since 1941. Such a ratio would still be quite conservative by most industry standards.

Debt exposure varies considerably among farmers and classes of farms. Some farmers continue to be almost entirely self-financed. Others are highly leveraged. As a general rule, the importance of debt financing increases as the size of farm operations increases. Commercial farms with annual sales in the $2,500 to $4,999 range, for example, had an average of only 5.6¢ in debt per dollar of assets on January 1, 1981. By contrast, the largest farms, those with annual sales of $100,000 and over, averaged 21¢ in debt per dollar of assets on the same date. Put another way, on the average, the largest commercial farms had about 3¾ times more debt per dollar of assets than the smallest farms.

Although financial leveraging can be a source of additional income under favorable economic conditions, it can be a powerful source of stress in periods of poor cash flow. One can expect the financial stress brought about by the current, prolonged poor cash flow experience to be most severe among large, nighly leveraged farmers.

Farm Credit System Lending Activity Fiscal Year 1981—Growth in total FCS outstandings slowed during the past fiscal year. FLBs, FICBs and BCs all showed this pattern. Combined FCS outstandings totaled $77.6 billion on September 30, 1981, a 15.9-percent increase over the year earlier level. This represents a marked slowdown from the 20.1 percent growth during FY 1980. Loans closed totaled $74.8 billion, a 10-percent increase over the last year. This growth rate is also below the previous year's 13.7 percent. Data on loan quality showed some weakening, but collection, delinquency, and foreclosure statistics remained highly satisfactory through September 30.

FLBs—The FLB outstandings continued to grow strongly, but at a slightly slower pace. Loans outstanding totaled $44.7 billion, up 21.4 percent during FY 1981, compared with a 23.6-percent rise

Table 10 — Farm Credit System Loans Outstanding and Made for the Year Ending September 30 with Percent Change from a Year Earlier, 1980 and 1981

System Loans	Amount		Change	
	1980	1981	1980	1981
	$ Billion		*Percent*	
Outstanding				
FLB	$36.8	44.7	23.6	21.4
PCA	20.5	22.9	14.9	12.2
FICB/OFI	0.8	1.0	24.3	29.0
BC	8.9	9.0	18.0	0.5
Total	**67.0**	**77.6**	**20.1**	**15.9**
Made				
FLB	10.6	11.6	27.4	10.1
PCA	32.5	35.4	17.9	9.0
FICB/OFI	2.2	2.1	47.2	-7.1
BC	22.8	25.7	30.4	13.0
Total	**68.0**	**74.8**	**24.8**	**10.0**

during FY 1980. There were 634,727 total borrowers on September 30, and 554,358 agricultural borrowers in the FLB system. Agricultural loans outstanding reached $42.1 billion, up 20.8 percent over a year ago. Rural home lending was up by 31.3 percent, well below the 44.4-percent pace of FY 1980. As of September 30, rural home loans outstanding totaled $2.6 billion. They now represent 5.8 percent of the total FLB portfolio.

FLB refinancings have leveled off from the high levels in 1980. January-June 1981 saw land bank borrowers use 47 percent of all farm loans closed to refinance debt. The greatest portion of this went to refinance land bank loans, followed closely by the long-term debt held by others. Land bank refinancing is sometimes used as a means of extending mortgage debt out over a longer period of time, thus extending repayment capacity. In other situations, land bank refinancing is used to take advantage of appreciated equity in land for farm expansion. The year also saw inverted interest rate relationships, with mortgage rates lower than the rates on short-term borrowing. This provided an additional incentive.

Overall land bank refinancing of short-term debt held by others slowed during 1981 when compared with the previous year. The first half of calendar year 1981 saw the portion of land bank loans used for the purchase of real estate increase to the 1979 levels of 30-36 percent, varying by season.

FLB repayment rates were below the previous 3-year average throughout FY 1981. Interest rates charged on the FLB loans have been very attractive, compared to other sources. This encouraged borrowing and discouraged prepayment. Agricultural loan delinquencies on June 30 were only 1.8 percent of the number outstanding, the same as last year, and 0.17 percent of dollar outstandings, very slightly above last year's level. Foreclosure actions remained at insignificant levels.

PCAs-FICBs—PCA lending growth slowed during FY 1981, with both loans made and loans outstanding growing at rates below the previous 3-year average. The period April through September saw a rebound in outstandings, after a very slow October-March period, but growth was still well below FY 1980 levels. On September 30, PCAs held $22.9 billion in outstandings, 12.3 percent above the ending FY 1980 level. Members with loans outstanding were up by 3.1 percent over the year. Agricultural loans were up 12.1 percent to $22.3 billion. Growth in the aquatic lending program continued at reduced rates during FY 1981.

Table 11 — Percentage Distribution of Federal Land Bank Farm Loans Made, By Purpose, and Quarter, 1977-1981

Purpose	1977				1978				1979				1980				1981	
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II
	(Percent)																	
Farm real estate purchase	37.5	31.5	27.4	28.4	34.0	31.3	30.4	30.4	39.9	33.0	31.5	31.0	36.4	27.2	24.2	30.3	35.8	33.4
Refinancing:																		
Mortgages held by Federal Land Banks	18.1	21.1	22.8	22.0	19.4	21.0	20.7	20.2	18.1	20.4	20.6	20.7	17.5	18.6	19.6	19.0	18.7	18.7
Mortgage loans held by others	14.9	14.4	14.9	15.9	17.2	15.0	14.6	15.2	14.9	14.8	14.5	15.0	15.7	17.5	16.4	15.6	15.7	15.1
Short term loans held by others	12.2	13.3	12.3	13.2	13.0	12.8	11.1	10.8	10.0	10.3	9.4	9.7	12.7	16.8	17.6	12.8	12.6	13.2
Total Refinancing	**45.2**	**48.8**	**50.0**	**51.1**	**49.6**	**48.8**	**46.4**	**46.2**	**43.0**	**45.5**	**44.5**	**45.4**	**45.9**	**52.9**	**53.6**	**47.4**	**47.0**	**47.0**
Other purposes[1]	17.3	19.7	22.6	20.5	16.4	19.9	23.2	23.4	17.1	21.5	24.0	23.6	17.7	19.9	22.2	22.3	17.2	19.6
All purposes	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1]Includes repairs and improvements to land and buildings, and other miscellaneous purposes.

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There was $0.5 billion outstanding on September 30, an increase of 17.3 percent.

PCA credit quality, based on a sample of PCA loans, has deteriorated over the past year. For the first 9 months of 1981, the amount of loans classified as acceptable—loans of the highest quality, ranging down to and including those having significant credit weaknesses—dropped by 1.7 percentage points to 84.4 percent of the amount outstanding. The combination of vulnerable and loss loans was 1.1 percent in 1981, a little higher than the 1978 level of 1.0 percent in 1981, a little higher than the 1978 level of 1.0 percent, but considerably lower than the 1975 peak of 2.5 percent. PCA collection rates have been only slightly below the FY 1980 levels and the prior 3-year average, through the greater portion of 1981.

FICB-OFI (other financial institutions)—Outstandings grew at a much faster rate than in FY 1980, as commercial banks made more extensive use of FICB discounting. As of September 30, $1.0 billion was outstanding, up 29 percent from a year ago. This figure represents 4 percent of the total FICB outstandings. Loans outstanding in the commercial lender participation program totaled $219.1 million, up 20.6 percent for the year.

BCs—Net growth in BC lending volume was very slow during FY 1981, but there was a substantial increase in advances and paydowns during the year. Loans outstanding grew by only 0.5 percent to about $9.0 billion on September 30. The number of cooperatives with loans outstanding increased by 24 to 3,548. Loans made during FY 1981 totaled $18.5 billion, an increase of 6.6 percent over FY 1980. Lending to rural electric cooperatives increased by 21 percent during FY 1981 to $1.3 billion. This figure represents 14.4 percent of the total BC portfolio, as compared with 11.8 percent in FY 1980.

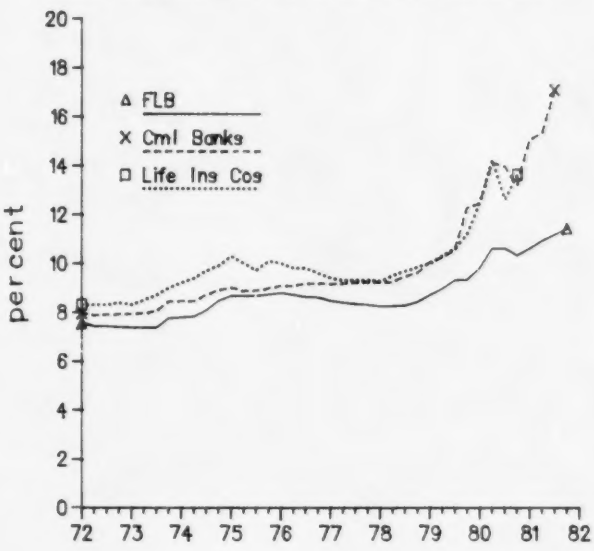
Interest Rates—Economic activity during 1981 was profoundly affected by interest rates which rose to historic levels. No sector of the economy emerged from the year entirely unscathed by the dampening influence of high credit costs. Housing and automobile markets were especially hard hit, given their dependence on credit.

If somewhat less dramatic, the effect on agriculture has been no less important. For example, interest charges on variable inputs and machinery ownership were 12 percent of the costs, excluding land, of producing corn in the U.S. in 1981. In 1978, the comparable share of cost for credit was 8 percent. For soybeans, interest expense was 14 percent of non-land production costs, up from 9 percent in 1978. The higher cost of credit, together with sagging farm income, served to dampen the demand for farmland. Similarly, agricultural machinery purchases fell from their depressed 1980 levels.

It should also be noted that only a portion of the farm debt has been affected by the rise in rates. Over half of the total farm debt is long term and secured by real estate, and over half of that debt carries interest rates that were fixed at the time the loan was made. Until the past 2 years, only the FLB system made variable interest rate loans, and the interest rate increase has been far below movements in the short-term money market rates, only reaching around 12 percent in late 1981. Farm nonreal estate borrowing is the component which now follows national money market rates very closely and is the main source of concern.

Estimates based on USDA information show that the average interest rate paid on all farm debt rose from 9.51 percent in 1980 to 10.13 percent in 1981. Another calculation, this made by the Federal Reserve, showed that only 13 percent of the shortfall in the purchasing power of net farm income of the sector between 1979 and 1981 was

Interest Rates on Farm Real Estate Loans



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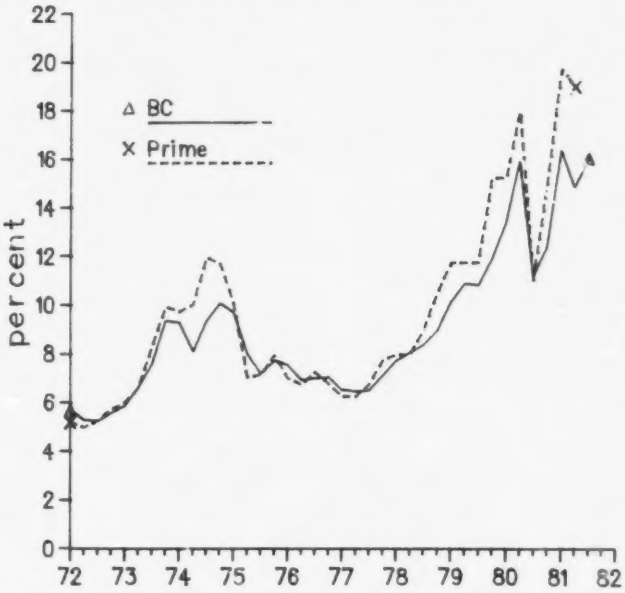
due to higher interest rates. Most of the gap could be closed only by strengthening of farm prices. Still, increases in interest rates have been and will be a significant contributing source of difficulty.

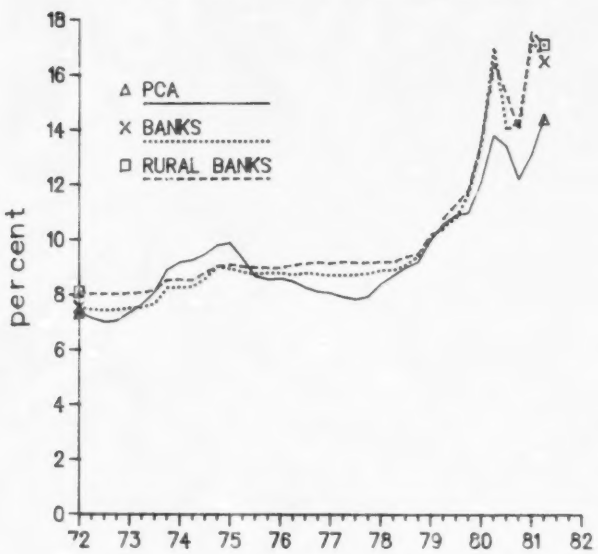
Interest rates charged by both production credit associations and Federal land bank associations, while high by historic standards, continued to be lower than those available from competing lenders. This advantage stems from (1) the continued success of the System in raising money from investors at attractive rates; (2) a very cost-effective procedure for making and servicing loans; and (3) the Farm Credit System practice of basing borrower interest rates on the average cost of its bond portfolio, rather than the cost of new funds raised. As bond rates trend upward, FCS rates follow, but at a slower rate as "cheaper" expiring issues are replaced by new issues at higher rates. Federal land bank rates display the least responsiveness to rising money costs because a greater proportion of its bond portfolio is devoted to longer term issues.

To some extent, stated rates are not strictly comparable with those of other lenders because they exclude: (1) changes in compensating balance requirements of commercial banks; (2) allowances for stock purchase requirements in the Farm Credit System; (3) differences in loan fees over time and between lenders; and (4) changes in the degree of nonprice rationing, such as minimum loan sizes, limits on size of loan, and the like.

Seasonal Interest Rate at the Banks for Cooperatives and the Prime Rate



Interest Rates on Farm Nonreal Estate Loans



Performance of interest rates during 1982 will be a critical concern for agriculture in general and the Farm Credit System in particular. Prospects for a reduced rate of inflation and sluggish economic growth lead many to expect a lower cost of money in 1982, at least during the first half of the year. This development would lend some strength to the demand for capital inputs such as machinery, equipment, and land that otherwise would continue to be weak due to generally dismal net farm income prospects. Some narrowing or reversal in the differential between FCS rates and those of other credit sources will occur as the cost of money declines over the year. Prospects for decline are greatest in the short-term lending area, especially for the banks for cooperatives' lending to large cooperatives. These loans are extremely sensitive to changes in interest rate differentials.

Farm Credit Securities—The Farm Credit banks obtain funds primarily through the sale of securities by their Fiscal Agency located in New York City. The banks introduced the Farm Credit Consolidated Systemwide Bond in January 1977, alongside existing separate bond issues of the Federal land banks, Federal intermediate credit banks, and banks for cooperatives. On January 1,

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1979, the Consolidated Systemwide Bond became the sole new bond issue of the Farm Credit banks. Bonds issued separately by the Federal land banks, Federal intermediate credit banks banks, and banks for cooperatives prior to this date remain available on the secondary market until their maturity.

1981 Financing—During the fiscal year ending September 30, 1981, the Farm Credit banks raised $55.4 billion through the sale of consolidated bonds. Federal land banks took $19.0 billion, Federal intermediate credit banks $25.2 billion, and banks for cooperatives $11.2 billion. Of the $55.4 billion, $10.4 billion was used for new lending (Federal land banks, $7.0 billion; Federal intermediate credit banks, $2.6 billion; and banks for cooperatives, $0.8 billion). The remainder went to refinance maturing obligations. The previous year, $49.9 billion was raised—$11.3 in new money and $38.6 billion for refinancing. The average interest cost for bonds sold during Fiscal Year 1981 was 15.9 percent compared to 12.20 percent for the same period in 1980.

Consolidated Systemwide Notes are the second vehicle used by the FCS for raising funds from financial markets. They also are the secured joint and several obligations of 37 Farm Credit banks. These notes, which are sold on a discount basis with a maturity of 5-270 days, are used to complement short-term borrowings, provide a source of interim funds between bond sales, and supply the banks with additional flexibility in securing funds during periods of unexpected demand.

Discount notes sold during fiscal year ending September 30, 1981, totaled $45.3 billion, an increase of 13 percent over the $40.0 billion raised through discount note sales in 1980. The average interest cost of discount notes in 1981 was 16.60 percent, as compared with 12.50 percent in 1980. The average maturity of these notes in 1981 was 26.7 days, with an average daily amount outstanding of approximately $3.2 billion.

1982 Outlook—In the first quarter of 1982, approximately 30 percent of the FICB and BC portfolios and 9 percent of the FLB outstandings will mature. Average short-term rates paid by the Farm Credit banks in the first quarter will decline from the 1981 average. New issues and refinancing of maturing short-term issues should lower the average portfolio cost of the FICBs and BCs by 100-120 basis points and the FLBs by 20 points. However, because of the preponderance of old long-term debt in the FLB portfolio, the additional cost in refinancing relatively inexpensive long-term debt will completely offset the decline in short-term costs. This suggests softening in the BC and PCA interest rates, but possible upward pressure on FLB rates.

Federal Land Banks—In 1982, the FLBs will be faced with significantly higher interest costs to refinance maturing long-term debt. In the first quarter alone, $1.6 billion in long-term debt with a weighted average cost of only 7.85 percent will mature. If the prevailing long-term rate in the first quarter is in the 12-14 percent range, a minimum of 20 basis points will be added to the October 1, 1981, average portfolio cost of approximately 11.5 percent.

The $4.8 billion of long-term securities maturing in 1982 represents 11.3 percent of the FLBs' total portfolio. Refunding of these issues can be expected to increase the FLB average cost of funds by 75 to 100 basis points, assuming the average maturity pattern on debt is maintained.

Federal Intermediate Credit Banks—Because the FICB system maintains a mix of short- term and long-term debt, not all of the decline in short rates will be completely transmitted immediately into lower portfolio costs. For Fiscal Year 1981, the FICBs paid an average rate of 16.2 percent on $15.1 billion in 6- and 9-month securities.

In the first quarter of 1982, $6.33 billion, 31 percent of the portfolio will be maturing at an average rate of 16.1 percent. If short-term interest rates are in the 12-13 percent range in that quarter, the average cost of the FICB portfolio would decline by 95 to 120 basis points.

Term debt (over 1 year) issued during 1981, totaled $1.0 billion at a weighted average cost of 14.38 percent. Throughout 1982, term bonds representing 5 percent of this portfolio will mature at an average rate of 8.5 percent. Replacing these funds will raise the FICBs' average cost by 40 basis points. Thus, if existing portfolio maturity is maintained, short issue costs will be cheaper but will be partially offset by a rising replacement cost of term issues.

Banks for Cooperatives—In the BC system, 28 percent of its portfolio, bearing a weighted average cost of 16.7 percent, will mature in the

first quarter. An anticipated 400-basis-point decline in the average cost of refinancing these issues will lower the BCs' average cost of funds by 115 basis points. Term bonds maturing in 1982 were originally financed at a weighted average rate of 8.8 percent, but comprise only 4.3 percent of the total portfolio. Therefore, assuming a new bond cost of about 13 percent, the average cost of funds will rise by about 25 basis points on the year. The average maturity of the BCs' outstanding issues remained constant during 1981 at 17 months.

Government Lending and Payments—Government lending programs and direct payment programs provide financing to a wide range of agricultural producers. During FY 1981, these programs provided $15.9 billion in loans and payments, up 39 percent from 1980. Administration budget cutting efforts can be expected to appear in FY 1982 figures. Availability of these programs has significant impacts on the financing needs from commercial lenders—banks, the cooperative Farm Credit System, insurance companies, and others.

One set of Government loan programs are intended to serve farm borrowers who cannot qualify for financing on commercial terms. These include Farmers Home Administration programs such as: farm ownership and farm operating loans, several small lending programs to special groups, and certain emergency lending programs. Recent administrative actions have tightened the "credit elsewhere" tests on the emergency lending programs and intentions are to substitute an expanded Federal All-Risk Crop Insurance Program for some of this activity. Thus, some of the risk protection that has been available without cost to farmers and lenders will now be available only on payment of an insurance fee by the borrower.

Table 12 — Total Government Agricultural Loans and Direct Payments Made During Fiscal Years 1980 and 1981 (Oct. 1-Sept. 30)

Agency and Program	1980	1981	Change from 1980	
	$ Billion		*$ Billion*	*Percent*
CCC-Commodity Loans	3.9	5.6	1.8	45
CCC-Storage & Facility Loans	0.4	0.2	-0.1	-38
ASCS-Deficiency & Disaster Payments	0.4	1.0	0.6	146
FmHA-All Farm Loans	6.3	8.1	1.7	27
SBA-All Farm Loans	0.4	0.9	0.5	127
Total	**11.4**	**15.9**	**4.5**	**39**

Another set of USDA farmer loan programs are available to all producers, without a "credit elsewhere" test. They are components of the farm price-support program, but provide important financing as a by-product. These include CCC commodity loans and storage and facility loans. Due to the large 1981 crops, prices are hovering near loan rates. It is expected that significant amounts will be placed under CCC loan or in the longer term reserve, providing an important source of farmer financing in 1982. The amount of funds available through CCC in any one year is not limited by the USDA budget appropriations.

The third Government source, ASCS direct payments to producers, is potentially available to all producers who comply with farm program provisions for specific commodities. Payments for those suffering natural disasters are likely to be phased out. Deficiency payments in event prices fall below certain levels will also be cut back if the Administration receives discretionary powers to set target prices. It is clear that Federal budget pressures are forcing the commodity programs in the direction that would provide smaller potential deficiency payments in 1982 and following years.

Total Government program activity provided farmer financing in FY 1981 of some $15.9 billion. This was nearly one-third as many funds as the $45.9 billion loaned to farmers by the largest private lender—the cooperative Farm Credit System. Substantial increases over FY 1980 came in CCC commodity loans, ASCS disaster loans, and FmHA and SBA loans. The SBA loans were being phased out during the second half of the year.

Farmers Home Administration farmer loan programs served a smaller number of borrowers and placed a smaller dollar amount of loans in 1981 than in 1980 except for one program. The natural disaster emergency program grew from 54,494 to 138,990 loans. Large numbers of agricultural counties had difficulties during 1980 which enabled them to be declared eligible for this loan program. Thus a single emergency program caused overall FmHA activity to increase.

Standards of eligibility for being declared a disaster county have been tightened for 1982, with final approval now coming from the Secretary of Agriculture. The expected effect, along with budget constraints on other programs, will be to

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Table 13 — Farmers Home Administration, Farmer Program Loans Made, Fiscal Years 1980 and 1981

Program	1980		1981	
	Number	*$ Million*	*Number*	*$ Million*
Farm ownership loans	12,972	954.1	11,853	813.3
Farm operating loans	32,211	874.8	29,838	847.6
Recreation loans (Indiv.)	26	2.3	22	1.8
Emergency loans	54,394	2,266.9	138,990	5,112.3
Economic emergency loans	44,887	2,185.5	27,348	1,245.3
Grazing association loans	3	4.3	0	0.0
Soil & water loans (Indiv.)	2,602	54.6	2,256	49.6
Irrigation & drainage loans	6	0.5	6	0.3
Indian acquisition loans	3	6.4	4	3.6
Total	**147,104**	**6,349.3**	**210,317**	**8,073.8**

reduce FmHA lending volume, on average, in the coming years. The activity of FmHA is expected to focus closely on servicing borrowers who cannot meet commercial lending standards but who have a reasonable hope of "graduating" to commercial sources in the future. Activity in 1982 also will include much servicing on the large numbers of loans issued over the past several years under the economic and natural disaster emergency loan programs. Agricultural conditions in some areas have not improved since these loans were made, resulting in widespread delinquencies. In part, however, delinquency is reported to be a deliberate loan servicing strategy. It permits the original, lower interest rate to continue. This is preferred to reamortizing or rescheduling the loan, which would have to be done at the current, higher interest rate and would worsen the borrower's liquidity problem. Generally, FmHA officials report that they do not anticipate any marked increase in foreclosure actions. Other recipients of FmHA emergency loans are scheduled to be reviewed in 1982, with the expectation that they can now meet commercial credit standards, and can be graduated to commercial lenders.

System Risks, Concerns and Opportunities.

1. The less-than-optimistic prognosis for agriculture in 1982 presents a challenge, indeed, a responsibility, to the Farm Credit System to remain committed to its member-borrowers during a difficult period. The year will be an opportunity to demonstrate this commitment by continuing to provide essential, professional credit services to the nation's farmers and ranchers.

2. More extensive loan servicing will be required, particularly with borrowers whose financial leverage is becoming overextended given a third successive year of poor farm income prospects. Debt restructuring, sale of individual land parcels, and careful budgeting will be required, but, locally, weak real estate markets may constrain some such adjustment plans.

3. FLB and FICB lending practices may require adjustment due to a lack of real growth in net worths. A third straight year in which land values fail to keep pace with inflation will diminish the opportunity (relied upon by some) to convert constantly increasing farm real estate values into operating capital and debt servicing funds.

4. Off-farm income counted upon to bolster a borrower's repayment capacity needs to be evaluated more carefully given serious weakness in the farm sector, as well as in most nonfarm sectors of our economy. Individual borrowers may be affected by businesses laying off workers, by reduced interest income, or by recessionary levels of nonfarm business earnings.

5. Although the level of FmHA lending may not be substantially different than that of recent years, the application of stricter eligibility standards may "graduate" many of its borrowers, especially from the economic emergency loan program, to commercial credit sources. Many of these "graduated" borrowers might have remained FmHA borrowers under eligibility standards applied in recent years. Other borrowers now with commercial lenders but who encounter repayment problems will not find FmHA available to carry them. Those "graduated" and other more marginal borrowers will increase servicing attention required of System loan officers.

6. The credit needs of young and beginning farmers present one of the most important challenges and opportunities faced by the Farm Credit System in 1982. The continued long-term strength of American agriculture

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depends on the sector's capacity to attract young and beginning farmers to replace those who retire or otherwise leave farming. New System lending authority to deal with young, beginning, and small borrowers (obtained in the Farm Credit Act Amendments of 1980) will need to be developed, and such programs will require much staff servicing. The new FmHA pilot program for getting family farmers started is expected to involve a number of association staff on advisory committees.

7. The recent precipitous decline in short-term money market interest rates is yet another reminder that interest rates will be volatile—both up and down. This may require changes in loan pricing procedures if System institutions are to avoid fluctuation in market shares. The PCA and BC systems are expected to have some lag in following market rates down quickly in early 1982. FLB rates are likely to continue upward, causing existing borrowers to question the average cost method of pricing loans, with its subsidy to new borrowers by old.

8. CCC lending programs are expected to be a major substitute for PCA and BC lending during much of 1982. Such activity will affect both loan servicing plans and funding projections.

9. Resumption of economic growth later in 1982 will likely tighten financial market conditions. Unless major strides are made in reducing the size of the Federal deficit, private and Government loan demands could combine to raise new concerns. In this situation, the status of the Farm Credit System as a debt market participant is likely to be critically discussed in policy circles. This visibility is a consequence of having become the largest institutional lender to agriculture, and hence a large borrower in money and capital markets.

10. FICBs can expect to receive many requests for information on establishing OFI relationships.

11. Growth in export demand for U.S. farm products will continue. To an increasing extent, farmer-owned cooperatives will be participants in this growth. The BC, through new export credit authorities, will have a major challenge in developing the capacity to play an essential role in meeting this opportunity for American agriculture.

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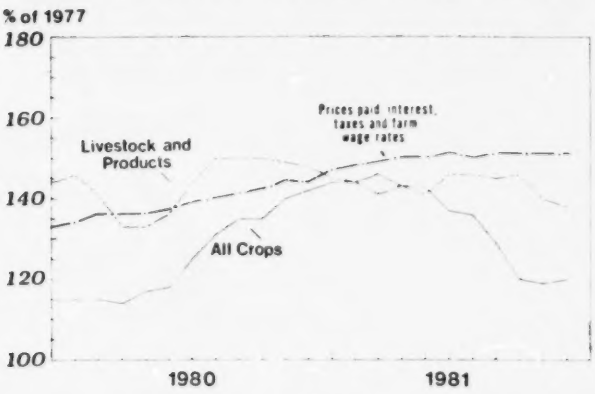
VI. OUTLOOK FOR COMMODITIES

Prices of farm commodities are expected to be generally weaker in 1982, as compared to 1981 levels. Livestock producers should earn positive net margins intermittently over the course of the year due mainly to lower feed costs; however, crop producers' profits will be squeezed because of lower crop prices combined with higher operating expenses.

The fiscal and monetary policies of the Administration will have significant impacts on the health of the agricultural sector. Sluggish economic activity in the first half of 1982 will limit consumer demand for meats and thus hold livestock prices down; however, improvement in the economy during the second half of 1982, along with the 10-percent reduction in personal income taxes in July, should lead to greater food demand and support for commodity prices. Additionally, influential factors such as interest rates, exchange rates and export markets, and the potential size of the harvest in the Southern Hemisphere should be monitored during 1982. Any of these could change the outlook for agricultural prices and production in the U.S.

Total meat supplies will be up slightly in 1982, with increases of 2 to 4 percent in beef production and 1 percent in broiler production more than offsetting an expected 3 to 5 percent decline in pork production. Prices for all types of livestock will not increase much above 1981 levels. Prices of fed cattle are expected to fluctuate around $65, hogs may rise from an average price of $46 in the first half of 1982 to $50 in the second half, and broilers may average around 47¢ for the entire year.

Index of Prices Received and Paid by Farmers



Greater production of all meats, combined with essentially unchanged prices, will cause cash receipts from livestock to increase to $73.5 billion in 1982 from $69.4 billion in 1981. With lower feed grain prices, cattle feeders and pork producers may earn limited profits assuming that the general economy does not enter a prolonged recession and that consumer demand holds up. Prices for stockers and feeders are expected to remain low, thus causing producers to show negative returns in 1982.

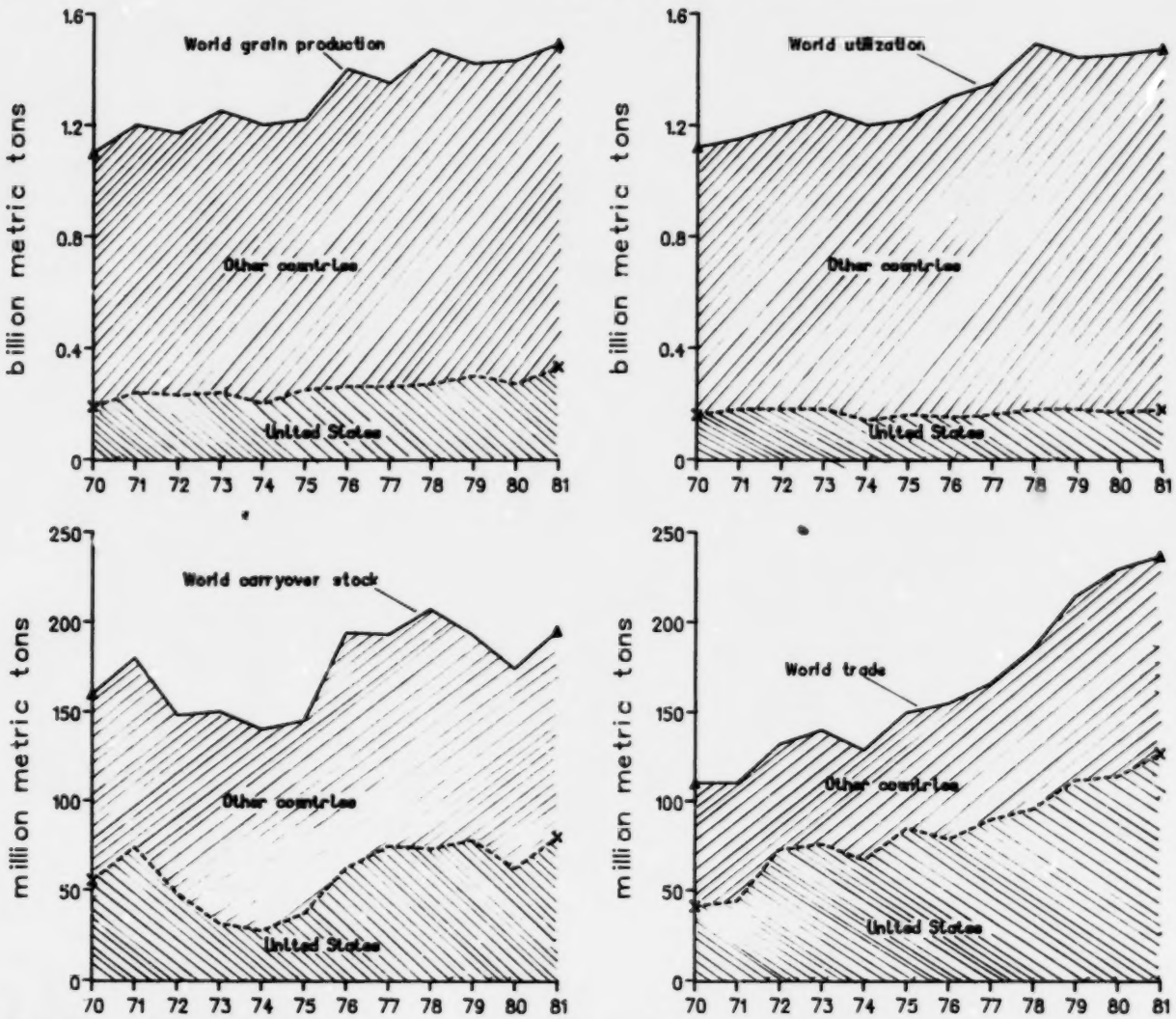
The outlook for crop prices is dominated by a fundamental situation of over-production and limited demand. Record harvests of food and coarse grains combined with sluggish growth in world economies will serve to hold crop prices down. In the U.S., cash receipts from crops should reach $76.7 billion in 1982, up from $73.7 billion in 1981. This increase is due largely to increased marketings, not higher prices.

Domestic disappearance of feed grains should increase marginally in 1982, because of increased cattle and poultry feeding. Also, lower interest rates, a reduced exchange rate for the dollar, and greater import demand from the Soviet Union should boost U.S. exports above the constrained levels of 1981. Greater utilization will not match the record production. Thus carryover levels will be large at the end of 1981/82 and prices are expected to average lower during the current marketing year.

Record production of wheat and rice will not be completely offset by rising consumption. Exports of wheat from the U.S. are projected to hit record-high levels in 1982, thus lending some strength to its price. Rice stocks, however, will build because of bumper crops throughout the rest of the world. Global cotton production reached record levels also in 1981. Cotton exports will continue sluggish due to poor performance by world economies, and prices will continue at low levels.

While the general outlook for commodity prices is bleak, this situation could be quickly reversed if the U.S. and world economies should grow at rates faster than currently expected. Further, if crops in the Southern Hemisphere are small or our exchange rates become more favorable relative to those of our competition, a resulting surge

World and U.S. Grain Production, Use, Carryover and Trade



Wheat, coarse grains and milled rice. Year beginning July 1.

in exports could strengthen crop prices considerably during 1982.

Meat, Dairy, Poultry, and Eggs

Total U.S. meat production was up slightly last year, but the rising population meant per-capita meat consumption was down. Per-capita consumption will remain below year-earlier levels through the first half of 1982. Projections of a similar drop a year ago triggered forecasts of significant upward pressure on all livestock prices. Though down, per-capita supplies turned out to be above expectations, while consumers' income remained weak and livestock prices continued to be lackluster. Expectations of an economic recovery, at least of one occurring quickly enough to significantly spur retail food demand during the next year, were more pessimistic in late 1981 than they were in the previous year.

Red Meats.

Cattle—The cattle industry as a whole operated under depressed economic conditions in 1981. All categories of cattle were marketed at or below average breakeven. The cow-calf and yearling operator experienced profitable years previous to 1981; therefore, their financial situation is not as depressed as that of the cattle feeder who has sustained continued financial losses over recent

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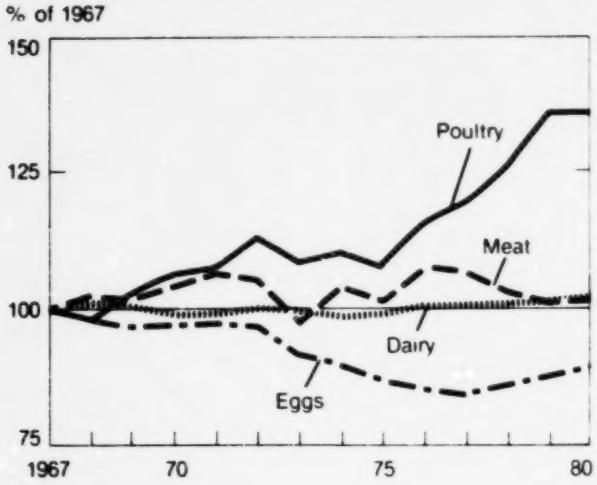
Per-Capita Consumption of Selected Animal Products



Dairy includes butter. 1980 preliminary.

years. A depressed national economy, and high interest rates appear to be the primary causes of the depressed livestock market at year end 1981.

A difficult year is projected for all sectors of the cattle industry during 1982. Improvement possibilities center around an early recovery in the general economy, which many analysts agree will not be apparent until at least midyear. Current interest rate levels and the availability of funds on a local level seemed to be easing at yearend 1981, and it is projected that this trend will continue. Meat imports, especially from Australia, are projected to be down due to that country's decision to use its productive land for grair. and sheep production.

Consumption of beef, assuming an economic turnaround at midyear 1982, is expected to remain at 1981 levels, with a higher second half offsetting a slight drop in the first half. Cattle on feed, however, are projected by USDA to increase markedly early in 1982. Reduced corn prices and near-record feed supplies indicate a cost-of-gain rate significantly below recent levels and conducive to increased cattle placements. Financial losses in recent years will cause feeders to attempt to buy feeder cattle at below break-even prices, based on current markets and projected cost-of-gain figures. It appears that the feeder cattle are available in large quantities due to the excellent weather and range conditions in 1981. Placements were slow late in 1981 due to the reluctance of producers to accept prices below cost; the stage is set. Total placements in 1982 are expected to be in excess of 1981 levels.

Total cattle numbers—well below the previous peak in 1975 of 132 million head—indicate a relatively healthy longer term situation for the industry. USDA data show considerable recent growth in numbers since the last cycle trough, but it is not projected that herd size will exceed 118 million head in 1982. It is noteworthy that there are large regional differences in the percent of cattle currently on hand compared to the 1975 peak level. Western and central states are only 5 percent and 15 percent, respectively, below 1975 levels, but southeastern states are 19 percent below the previous high. Depressed crop markets plus drought conditions contribute to this situation.

USDA forecasts that overall cattle herd growth will be limited by the availability of grazing land—15 to 20 million acres have recently been converted from grazing to cropland. It remains to be seen whether cattle herd growth in times of profitability will be affected. In many cases, increased land productivity has created more opportunity for by-product utilization by livestock and grazing capability has increased. Also, it appears that grazing capacity would permit a total cattle herd size ample to meet expected levels of meat demand.

The cow-calf producer is likely to suffer financial losses in 1982 due to the pressure on feeder prices exerted by a financially strained feeder industry. Strong discrimination against heifer calves in the marketplace will encourage many producers to hold heifers, hoping for price improvement in the spring of 1982. Historically, this practice has resulted in many of these animals moving into the breeding herd.

Projected prices, based on the assumption of an overall economic upturn by midyear, indicate fed cattle improving from the low 60s in late 1981 to the 65 cent range by midyear, with the possibility of the high 60s by yearend. The effect of these projections on the various facets of the industry are obvious; 1982 will see further financial losses for the producer and limited profit for the feeder. These price projections are on the high side if the economy does not not experience the anticipated upturn by midyear. On a more optimistic note, the cattle numbers and low per-capita consumption

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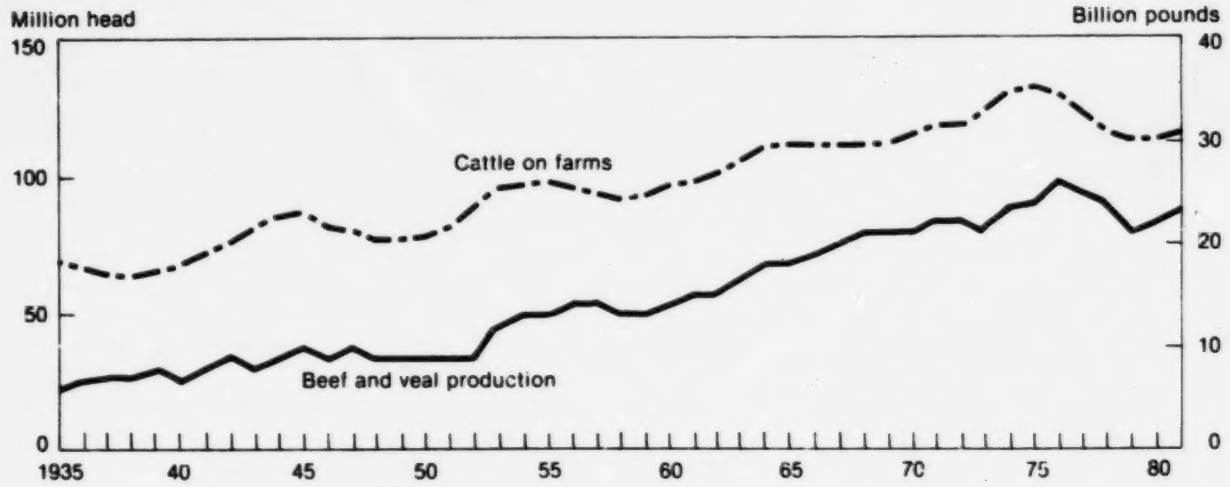
Cattle Numbers and Beef Production



Cattle and calves on farms January 1. 1981 production forecast.

suggest that the industry is poised for improvement if we have an unexpectedly early or strong improvement in the overall economy.

Hogs—Modest improvement in hog prices is expected in 1982 as annual production is reduced approximately 4.5 percent from 1981. Most of this reduced production will occur in the first half of 1982, but hog prices will not improve significantly, as domestic pork output will remain relatively high and there will be larger supplies of other meat.

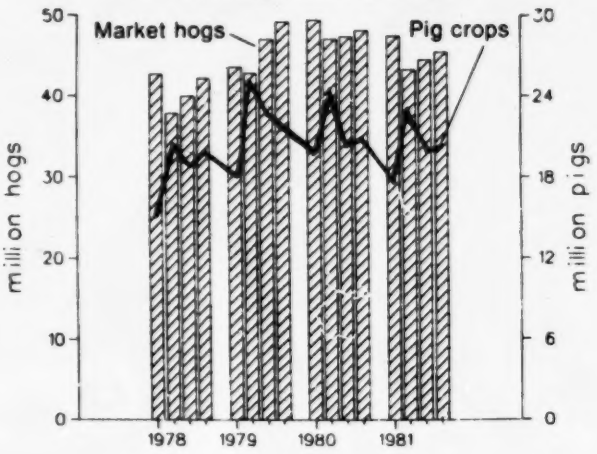
As of September 1, 1981, the hog breeding inventory was estimated at 7.06 million head, down 5 percent from a year earlier. Market hog inventory, at 45.1 million head, was 6 percent less than a year ago. Earlier forecasts of hog marketings overstated production cutbacks, because producers have since been reacting to abundant supplies of lower priced feed.

Current indications support an expected 7-percent decline in slaughter in the first quarter of 1982, as compared to the previous year, and a second-quarter that is expected to be about 5 percent lower. Almost the entire reduction is expected to take place in states other than the western Corn Belt states of Nebraska and Iowa. Prices for the first half of 1982 are expected to average $46-$48 per cwt. for barrows and gilts at seven markets, up $4-$6 from the January-June 1981 average.

Second-half hog production is less certain, as producers' intentions are subject to considerable change. Expectations are for a 4-percent decline in third-quarter slaughter with the fourth quarter equal, both compared to the same periods of a year earlier. The slightly lower levels of production and expectation of improving consumer incomes support a second half average of $50 per cwt., up only moderately from the July-December 1981 average.

Hog producers have been experiencing negative or marginal returns for the past 2 or 3 years, due primarily to low pork prices and high interest and feed costs. The record feed-grain harvest in 1981

Market Hogs and Pig Crops



Pig crops—December-February, March-May, June-August, and September-November. Market hogs on farms—December 1 previous year, March 1, June 1, and September 1. Quarterly data for 14 states.

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has significantly reduced feed costs, which are expected to run approximately 20-30 percent below costs experienced in the first half of 1981. Therefore, hog profits are likely to increase moderately.

In spite of expectations for total pork production decreases in 1982, it is likely that production in the Corn Belt states of Nebraska and Iowa will remain constant or increase slightly. These areas offer low feed costs and have less attractive alternative markets for feed stuffs; therefore, pork production cutbacks will be most predominant in the Southern states.

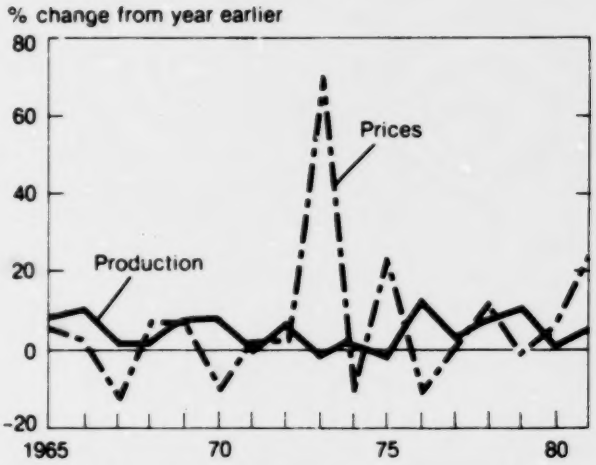
Demand for pork in 1982 offers little support for further price improvement. In addition to continued relatively high supplies of pork, other meats, also at high supply levels, will compete for the consumer's dollar. Retail pork prices are expected to rise approximately 8-11 percent in 1982—mainly as a result of increased processing and marketing costs.

Sheep and Lambs—Increasing commercial production of lamb and mutton, combined with abundant supplies of beef and broilers, lower disposable income for consumers, and large stocks of frozen lamb and mutton continue to create market share pressure on the sheep industry. This suggests that prices will hold at or below current levels. The large 1981 lamb crop of 8.8 million head, 8 percent above last year, will be the primary reason for the large increase in commercial production. Much improved pasture and range conditions compared to last year will also contribute to increased production during the summer months. Commercial slaughter will remain higher than year-earlier levels throughout 1982. Per-capita consumption of lamb, approximately 1.5 pounds in 1980, will remain relatively constant through 1982. In 1960, consumers spent 16 percent of their red meat and poultry expenditures on lamb. As lamb and sheep numbers fell, this percentage dropped to 5 percent during 1980. Texas, California, South Dakota, and Wyoming will continue to produce a large portion of the lamb crop—approximately 40 percent.

Poultry and Eggs.

Broilers—Broiler fundamentals point to a somewhat more favorable year in 1982. But with the economy sinking back into a recession during the last quarter of 1981, the brighter prospects

Broilers: Changes in Production and Farm Prices



December 1 previous year through November 30 current year. 1980 preliminary, 1981 forecast.

may disappear as they did a year ago. Broiler producers are still enduring an unusually long period of unfavorable returns. Except for the third quarter of 1980, negative returns have generally persisted since mid-1979.

Producers can expect more favorable feed prices. But other costs are expected to rise and more than offset the somewhat lower feed costs. The prospect of moderating costs and a stabilization of the hatcherey flock suggest that producers will expand output about 1 percent in the first half of 1982 compared with a year ago. This represents a significant slowing in year-over-year gains—on a quarterly basis for 1981, those were 3, 5, 11, and 4 percent.

An abundant supply of broilers will keep downward pressure on prices through midyear. USDA expects that the nine-city weighted average wholesale broiler price will be slightly below that of the first half of 1981. As with the red meat animals, prospects for higher second-half prices will be primarily a function of conditions in the general economy.

One bright spot for producers is the export market. Young chickens (mostly broilers) exported were up 45 percent over 1980. The bulk of this increase was caused by large increases in exports to three countries: Egypt, Japan, and Iraq. Exports to all three virtually doubled in 1980, with Egypt moving ahead of Japan to become the major importer of the United States' chickens.

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The U.S. will continue as the world's leading single-country exporter of poultry meat in 1982, possibly exporting .47 million tons for a 10-15 percent gain above 1981.

Turkeys—Storage facilities are packed with frozen turkey. This past October 1 found cold storage stocks 31 percent over those on the 1980 date. Per-capita consumption during the first three quarters of 1981 was off 8 percent. A reversal of this consumption pattern was necessary in the fourth quarter to reduce stocks to a manageable level.

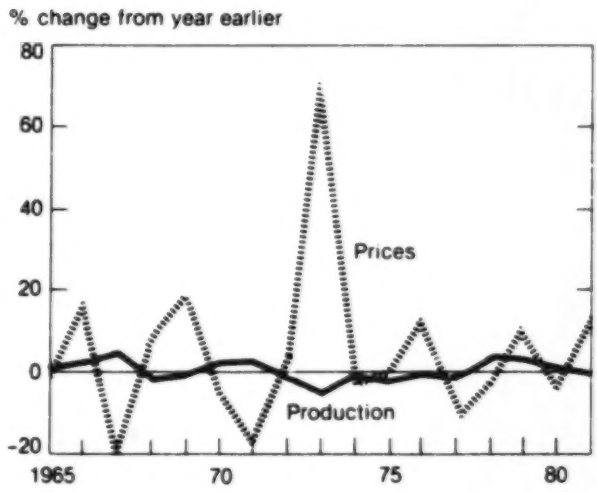
A continuation of large turkey stocks in 1982 will depress prices during the first half of the year. Even though feed prices will be lower, producers will experience unfavorable returns. This, in turn, will reduce hatchery activity. Turkey production is expected to decline in 1982 by 4 to 6 percent—3 percent in the first half and 7 percent in the second.

Prices of young hens may average 53-57 cents during the first half of 1982, down from 62 cents in 1981. Assuming a reduction in 1982 production, cold storage stocks will be much lower and will help to support prices in the 67-71 cents-per-pound range for the second half of 1982.

Egg Outlook—Egg production in 1982 is likely to range between the production level seen last year to 2 percent lower. Feed price declines should have a moderating effect on production cost totals, but probably not enough to pull producers completely out of the cost-price squeeze they experienced through much of 1981. The strength of the general economy in 1982 will exert an influence on price levels for eggs and other high protein food products. If the economy remains sluggish, dampened demand for eggs will hold prices down. Egg prices are projected to average between 73 to 75 cents per dozen in the first half and increase seasonally to between 76 to 78 cents per dozen during the second half.

The egg-type chick hatch in September of 1981 was 14 percent below the levels of a year earlier. This hatch is the source of replacement pullets. As profitability increases, producers have been keeping their hens in production longer to offset declines in replacement pullets. The relatively high levels of forced molting seen in 1981 are likely to continue in 1982.

Eggs: Changes in Production and Farm Prices



1980 preliminary, 1981 forecast.

The productivity gains seen in this industry in the last 3 to 4 years will be less likely to occur in 1982 because of the fewer replacement pullets and the aging of the flock. On the plus side, feed costs should be lower, which would improve profitability and encourage hanging onto hens longer.

Dairy.

Milk—The farm level price of milk will remain very dependent on the support price until production and consumption are brought into better alignment. USDA forecast this will begin to occur in late 1982, but less optimistic sources forecast that adequate adjustments will not begin before 1983. In the meantime, manufacturing milk prices are likely to continue below support levels and CCC purchases will remain very large.

Though the 1981 Farm Bill was in conference at the time of this writing, it appears that the support level will be $12.80 per cwt. for 3.5 percent milk until October 1982. After that, it may continue at $12.80 or rise to 72.5 percent of parity, which would be about $13.80 for 3.5 percent milk. In October 1982, 70 percent of parity would be about $13.34 per cwt. for 3.5 percent milk.

Total production set another record in 1981 at 132 billion pounds, 3 percent above the previous record year 1980. Output per cow continued to increase (2 percent) and the cow herd grew 0.7 percent to the largest size since 1977. But consumption was up only about 1 percent to 119

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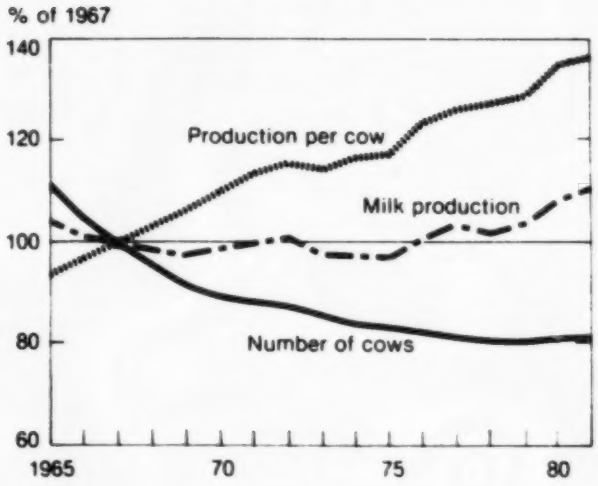
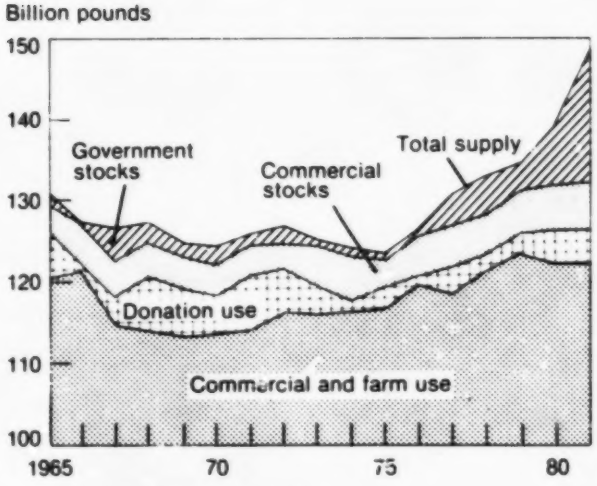
Milk Production, Number of Cows, and Milk per Cow



1981 forecast.

Milk Supply, Use, and Stocks



Stocks as of December 31. 1981 forecast.

billion pounds. As a result, the CCC was left to purchase about 13 billion pounds of milk equivalent—about 10 percent of the 1981 production.

As feed prices fell, the milk-feed price ratio rose to a favorable 1.53 in October 1981, the highest level in 16 months. Low feed prices and a favorable milk-feed ratio are expected to continue through the first half of 1982. These will probably encourage high concentrate feeding and may renew increases in production per cow.

Heifer replacement ratios were record high in July 1981 (42.6 per 100 cows). This has implications for strong production per cow increases in the next few years, even if they do not swell the cow numbers.

Based on the heifer ratios, relatively low cull cow prices forecast into mid 1982 and a high milk-feed ratio, production may increase 2 percent to 135 billion pounds in 1982. Consumption is unlikely to show a net increase. While an increase in cheese consumption is forecast with an improving general economy, this will be offset by losses in fluid sales to the school lunch program as the new USDA school lunch guidelines go into effect. As a net result, CCC purchases in 1982 should be about 15 billion pounds, costing $2.5 billion.

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The Grains, Oilseed and Fiber Complex

Record or near record 1980/81 world production of grain, oilseed and fiber crops and an overall, somewhat sluggish demand dominate the economic environment for the 1981/82 crop year. With the exception of wheat and oats, the price outlook for all these crops is bearish. Wheat is supported by improved but still tight world stocks. The export market holds the key to price movements.

Factors to watch in connection with exports are the value of the U.S. dollar, interest rates, world economic strength, and 1982/83 world crop prospects. Season average farm prices discussed during or immediately following the November USDA Outlook Conference for 1981/82 crops are as follows:

Commodity Unit	80/81 Season Avg. Price	Forecasted 81/82 Avg. Farm Price
Corn/Bu.	$ 3.10	$ 2.55–2.80
Sorghum/bu.	2.95	2.35–2.55
Oats/bu.	1.82	1.80–1.90
Barley/bu.	2.91	2.45–2.60
Wheat/bu.	3.96	3.80–3.95
Rice/cwt.	12.00	9.00–10.50
Soybeans/bu.	7.61	5.75–6.75
Peanuts/lb.	.264	.23– .24
*Cotton/lb.	764	.68– .70

*The cotton forecast is from private sources. USDA is prohibited by law from forecasting cotton prices. 1980/81 cotton price is for the first 8 months only.

USDA per unit cost of production estimates for calendar years 1979, 1980, and 1981 are as follows:

Per Unit Cost*

Community Unit	1979 All Costs	1979 Variable Costs	1980 All Costs	1980 Variable Costs	1981 All Costs	1981 Variable Costs
Corn/bu.	$2.42	$1.03	$ 3.66	$1.51	$ 3.70	$1.54
Sorghum/bu.	2.74	1.02	4.42	1.64	3.97	1.49
Oats/bu.	2.48	.84	3.40	1.10	3.43	1.12
Barley/bu.	3.38	1.18	4.14	1.39	4.40	1.60
Wheat/bu.	3.94	1.39	5.08	1.86	5.80	2.14
Rice/cwt.	9.24	4.83	11.65	6.11	12.98	6.85
Soybeans/bu.	5.50	2.00	7.64	2.77	7.57	2.76
Peanuts/lb.	.233	.115	.444	.218	.308	.153
Cotton/lb.	.747	.410	1.270	.605	1.195	.576

*Land charge in "all costs" is based on share rental charge for land.

Note: the drought-lowered 1980 yields gave rise to large per unit cost increases during 1980 and some drops in 1981 as yields rebounded.

Expected 1982 prices for these crops fall short of covering costs when typical land rental costs are considered. Unit production cost will vary considerably among farms based on natural resources, operator management ability, and debt levels. A comparison of unit cost of production and forecasted 1981/82 prices points out the economic stress facing some crop producers, particularly highly leveraged operators and tenant farmers.

The outcome of the proposed farm bill was still "up in the air" as this report was drafted. Government commodity programs, however, are expected to provide a lower real level of support to prices than in recent years. If a land set-aside program is required, participation in grain programs is expected to be low. Market prices for cotton, rice, wheat, sorghum and barley have been close to or below the 1981 target prices; about $1 billion of deficiency payments will be paid to producers. With the exception of sorghum, for which payments are made in the spring, these deficiency payments are typically made between December 1 and the end of January.

1981 loan rates, target prices and reserve trigger levels are currently as follows:

1981 Crops

Commodity Unit	Regular Loan	Reserve Loan	Target Price	Reserve Trigger
Corn/bu.	$ 2.40	$2.55	$ 2.40	$3.15
Sorghum/bu.	2.28	2.42	2.55	3.00
Barley/bu.	1.95	2.07	2.60	2.55
Oats/bu.	1.24	1.31	—	1.60
Wheat/bu.	3.20	3.50	3.81	4.65
Rice/cwt.	8.01	—	10.68	—
Soybeans/lb.	5.02	—	—	—
Peanuts/ton	455.00	(quota)		
(Support loan)	250.00	(non quota)		
Cotton/lb.	5246	—	.7087	—

A comparison of the provisions in the House and Senate versions of the new Farm Bill (as taken to Conference Committe in early November) are as follows:

House and Senate Target Prices and Loan Rates, 1982

Commodity		Senate*	House**
Wheat	target price:	$ 4.00	$ 4.20
	loan:	3.50	3.55
Corn	target price:	2.70	2.90
	loan:	2.50	2.65
Cotton	target price:	.71	.69
	minimum loan:	.55	.55
Rice	target price:	10.73	11.90
	loan:	8.00	8.00
Peanuts	quota loan:	596.00/ton	eliminated

*All target prices in Senate bill provide incremental increases annually; 20¢ a year for wheat; 15¢ for corn; 5¢ for cotton; and 50¢ for rice. Authority is given USDA to implement acreage reduction. The cotton loan rate is based on 85 percent of U.S. spot markets in five previous years, except the highest and the lowest, or 90 percent of the European market for 15 weeks after July 1. Rice loan rates bear the same ratio to target price as in 1981. Acreage allotments for rice are suspended. Peanut loan rates are increased according to average cost of production each year. Soybeans have a loan rate established at 75 percent of the average price received by farmers in the previous 5 years, excluding highest and lowest, but not less than $5.02/bu. There is no acreage reduction or target price authority for soybeans.

**The House bill indexes all increases in target prices on wheat and feed grains to cost of production, and loan rates are to bear the same ratio to target price as in 1981. It would require the Secretary of Agriculture to order land set-aside programs coupled with bonus increases of 5 to 15 percent in wheat loan rates, when wheat carryover exceeds 6 percent of world usage for the coming year. For feed grains, if the average farm price is below 105 percent of loan, the Secretary of Agriculture may drop the loan by 10 percent, but not below $2.00/bushel. Also a set-aside is mandatory if carryover is more than 18 percent of previous year's use. The cotton program is the same as the Senate version except the target price is set at 120 percent of the loan rate each year. For rice crop years 1982-85, loan rates are tied to the target price as in the Senate, but not less than $8.00 per cwt. Rice target prices are not fixed in dollar amounts, but are estimated at $12.98-$13.20 for 1983, $14.01-$14.51 for 1984,

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$15.06-$15.82 for 1985. Rice acreage allotments are suspended and set-aside is discretionary. For peanuts, acreage allotments and marketing quotas are eliminated; the Secretary of Agriculture is given discretionary authority to establish loan rates. The soybean program is identical to the Senate version.

Feed Grains.

Corn—The corn situation offers little likelihood of significant price improvement during the current marketing year. Production, usage and economic factors will continue to influence corn prices, but during the next 6 months, increased exports offer the most potential to strengthen corn prices.

Favorable growing conditions last summer dramatically improved corn prospects from early season expectations. In July, the U.S. crop was forecast at 7.1 billion bushels, up substantially from the 1980 drought-reduced crop. There was particular concern about the eastern Corn Belt crop, which was planted much later than normal. Also, parts of Nebraska and western Iowa were extremely dry; however, as the season progressed, timely rains and slightly above normal temperatures improved production expectations. Later than usual frosts permitted the crop in the eastern Corn Belt to mature. Production forecasts increased each month, and as of November 1, the U.S. corn crop was forecast at a record 8.1 billion bushels, up 22 percent from 1980, and 2 percent from 1979.

Only a marginal increase in overall corn usage is expected, despite abundant supplies and low prices, with the projected increase shared between expanded domestic use and exports. Increases in beef and broiler production are expected to result in a 3-percent increase in the amount of corn used for feed in 1981/82. Ample supplies and low prices of other feed grains will restrict additional corn usage. There will continue to be increased corn usage for the production of gasohol and high fructose corn syrup. USDA has projected exports for the 1981/82 year to be 2.45 billion bushels, an increase of 4 percent from 1980/81.

Crop developments in the Southern Hemisphere will play an important role in the level of U.S. exports during the next 6 months. Any significant reduction in those crops, due to adverse weather, would enhance the opportunity for additional export volume. Also, any indications of reduced production later in 1982 in the U.S., or in other major producing regions which would reduce global stocks, could stimulate an increase in our current marketing year exports. In addition, any speeding of economic recovery in our major importing nations or a weakening of the dollar relative to their currencies would stimulate exports.

Total U.S. corn disappearance is expected to reach 7.5 billion bushels. Thus, our large 1981 corn crop results in a projected 81/82 yearend carryover of 1.63 billion bushels. This is only the second time since 1965 that such stocks will have exceeded 1.3 billion bushels. Yearend stocks will represent 22 percent of projected annual U.S. utilization.

USDA's November forecast is for a 1981/82 season average farm price of $2.55 to $2.80 per bushel compared to last year's record price of $3.10. The quantity of corn placed into Government loan reserve programs will hold the amount of grain available for marketing at reduced levels. This should hold prices up to the projected minimum. Significant changes in exports and/or usage will be needed to push prices above the projected top side figure. Among the factors recently restricting U.S. exports, high interest rates and the strength of the U.S. dollar show signs of easing.

Sorghum—An abundant crop and lower market price head the outlook for sorghum in 1982. The 1981 crop of 876 million bushels was the largest since 1973, and was 49 percent above the 1980 crop. It means that total supply increased to approximately 985 million bushels. A 43-percent increase in feed use is projected due to prices being lower than corn. But exports are expected to show little change. This results in a doubling of ending stocks to 224 million bushels. Sorghum prices at the farm for the 1981/82 crop year will likely average $2.35-$2.55 per bushel, down from $2.95 in 1980/81.

Barley—The outlook for barley indicates a significantly lower farm price this marketing year, as the U.S. produced a record crop, 33 percent above the 1980 outturn. Improved weather conditions in the major barley production regions relieved the drought conditions of 1980 and increased both harvested acreage and yields. With U.S. beginning stocks of 136 million bushels and an estimated 1981 crop of 476 million bushels, the total U.S. supply of barley reached 622 million

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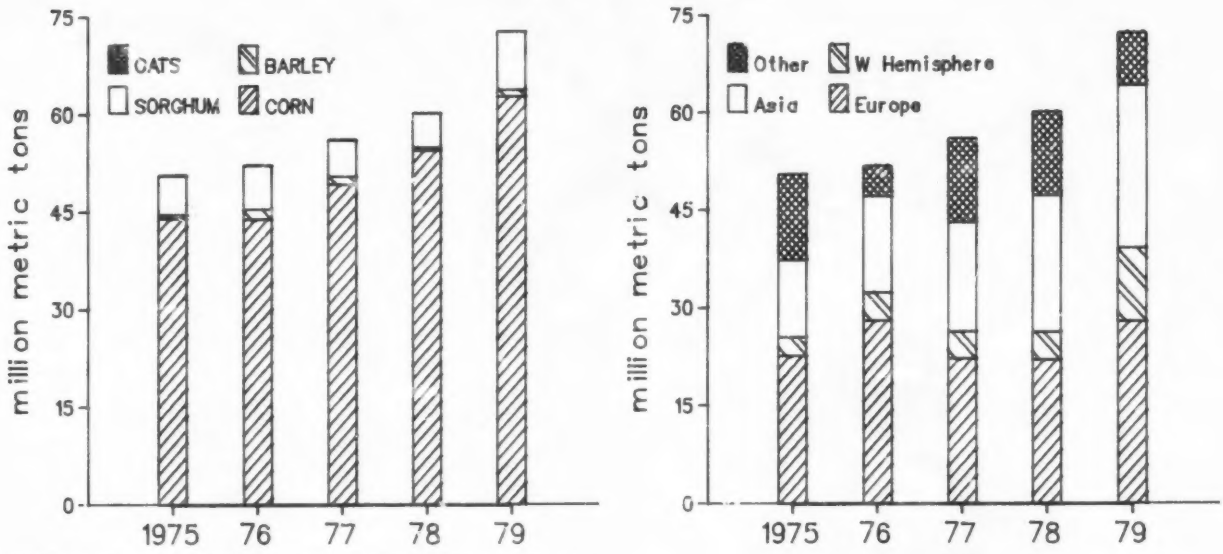
U.S. Exports of Coarse Grains



Marketing year beginning October 1 for corn and grain sorghum, and June 1 for barley and oats. Includes corn and cornmeal for relief, hominy and grits, cornstarch and barley meal.

bushels, 11 percent above the previous year. Increased feed use due to a favorable price relationship with corn and a strong import demand from Spain, Morocco, and the Soviet Union, indicates total barley use will be approximately 475 million bushels. Ending stocks of 147 million bushels, 8 percent higher than the 1980/81 crop year, will put downward pressure on prices despite the strong potential for exports. Prices received by farmers should be in the $2.45-$2.60 per bushel range for the 1981/82 crop year, compared with the 1980/81 season average farm price of $2.91.

Oats—The 1981 oat crop was estimated at 509 million bushels, 11 percent more than 1980's production. But the 1981/82 oat supply at 687 million bushels is only 1 percent over 1980. Domestic use of oats will be about 510 million bushels, also a 1-percent increase from 1980. Exports will run about 10 million bushels, down from 13 million last year. With total use exceeding production, ending stocks are expected to decrease about 10 million bushels, a 6-percent decrease.

Oat prices at the farm are expected to average between $1.80-$1.90 per bushel during the 1981/82 crop year, compared to $1.82 per bushel in 1980/81. Oats is the only cash grain crop projected to have stronger prices.

Food Grains.

Wheat—The 1981 U.S. wheat crop is estimated to be 2.75 billion bushels, a 16-percent increase compared to the 1980 record crop. This crop reflects the largest area ever planted to wheat, 88.8 million acres and a near-record average yield of 34.1 bushels per acre. This yield is 2 percent higher than the 1980 average of 33.4 bushel yield.

The total domestic supply of wheat reached an all-time high of 3.7 billion bushels for the 1981/82 marketing year, a 14-percent increase over 1980/81. In addition to the record crop, there was a carryover of 988 million bushels—the first increase in carryover since 1978. This is the fourth time in 5 years that the total U.S. wheat supply has exceeded 3 billion bushels.

A major portion of the large 1981/82 wheat supply will disappear due to increased demand during the year. Total wheat use during the current marketing year is estimated at 2.8 billion bushels, a 21-percent increase over last year. Domestic use is projected to reach 932 million bushels, primarily the result of a sizable increase in feed utilization. The estimate for feed use is based on the large wheat supply, strengthening cattle prices and wheat's feeding value relative to feed grain's.

The potential for increased U.S. exports during the 1981/82 marketing year is strong because of

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reduced world carryover, and a 6-percent reduction in production prospects for major wheat importing countries. The world import demand is projected to reach 105.6 million metric tons, 10 percent higher than in the 1980/81 crop year. The U.S. is the only major wheat exporter with adequate supplies to meet a significant increase in demand. If wheat exports are not adversely affected by the relatively strong U.S. dollar, high interest rates, and weak world economies, the U.S. could export a record 1.9 billion bushels of wheat, 26 percent over the 1980/81 year.

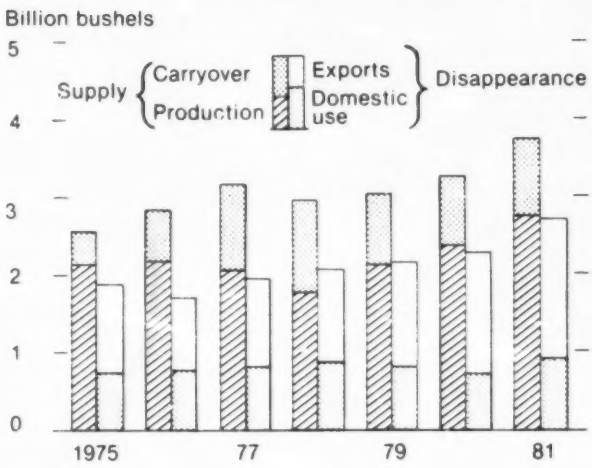
Ending stocks for the 1981/82 marketing year are expected to total 908 million bushels, 8 percent lower than the carry-in level. More importantly, producers are expected to make heavy use of the farmer-owned reserve program. This could drop ending "free stocks" to about 250 million bushels from near the 450 million bushels at the end of the two prior marketing years. Prices should range between $3.80 to $3.95 per bushel. But expanded exports remain as the key element in maintaining the price near the previous season's level.

Rice—Prospects for weaker export demand against a record supply portend that sharply lower prices will dominate the U.S. rice outlook for 1981/82. U.S. production is estimated at about 183 million cwt., up 26 percent from last year and contributing to a second straight record world crop (408 million tons rough basis). Ending U.S. rice stocks are projected to reach 60 million cwt., which will exert considerable downward pressure on rice prices. The large ending stock projection reflects a weaker export demand picture for U.S. rice, especially from South Korea, which has been our leading export customer in the past. Many of the major rice importing countries will have substantially improved production and this, along with a strong U.S. dollar and high interest rates, will likely hold our rice exports to 80 million cwt., a 10-percent decrease from last year. The season average price for rice in 1981/82 is anticipated to fall between $9.00 and $10.50 per cwt. With a target price of $10.68 per cwt., deficiency payments will be made to allotment holders.

Oilseeds.

Soybeans—The 1981 soybean plantings were 68.1 million acres, 2 million acres below that planted in 1980, even with a record 15 percent of the acreage double-cropped. This decrease was the result of lower soybean prices relative to corn and cotton prices. But even with 3 percent fewer acres, 1981 production is estimated at 2.1 billion bushels, 13 percent above 1980. With beginning stocks of 320 million bushels, soybeans supplies for 1981/82 are placed at 2.4 billion bushels, 11 percent above 1980/81, and only marginally below the record supplies of 1979/80.

Wheat Supply and Disappearance



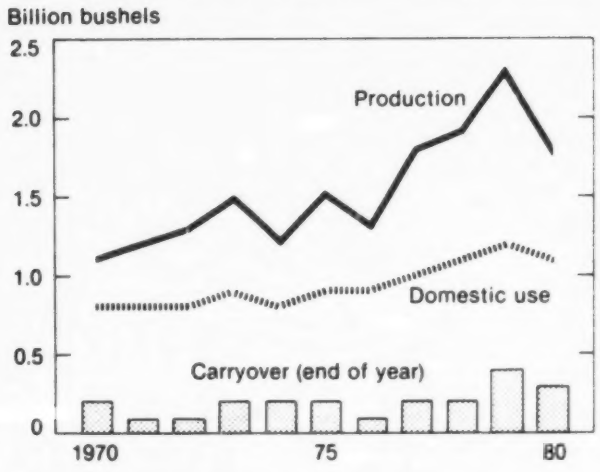
Supply includes imports. Year beginning June 1
1980 preliminary. 1981 projected

This season's larger supplies and lower prices are expected to cause total use of soybeans to increase to 2 billion bushels, nearly 9 percent above 1980/81. Weak economic growth, a relatively flat livestock sector, and the strong U.S. dollar will moderate increases in total use. Thus, the gain in use is more in response to lower prices than factors which underlie shifts in the demand for soybeans.

Domestic soybean meal use should increase to 18.3 million tons, with the 6-percent rise the result of more favorable pork/meal and broiler/meal price ratios. The domestic market accounts for about three-fourths of total soybean oil use. Primarily then, on the basis of this season's low soybean oil prices relative to other oils, soybean oil use should be about 9.5 billion pounds, 4 percent above 1980/81.

The United States will increase its share of world soybean trade, regaining some of the market lost in 1980/81 when our share of world soybean production fell. U.S. soybean exports are forecast at

Soybean Production, Use and Carryover



Domestic use includes crushings, seed, feed, and residual.
Year beginning September 1.

830 million bushels in 1981/82, 15 percent above 1980/81. Exports should be up because of improved crushing margins in Europe and increased Soviet Union imports to augment their short supplies of feedstuffs. In addition to the expanding import requirements in these locations, the U.S. will experience less competition from producers in the Southern Hemisphere, at least during the first half of the U.S. marketing year.

Oil prices could slide further from already depressed levels, averaging in the range of 20 to 24 cents a pound in 1981/82. Meal prices are expected to average in the range of $170 to $195 a ton, well below the 1980/81 average of $218.

Primarily as a result of this season's increase in supply and decline in oil and meal prices, soybean prices are forecast to average sharply lower. At the farm, prices are expected to average in the range of $5.75 to $6.75 a bushel, down from the 1980/81 average of $7.61.

Except in years of below-normal crop, soybean prices tend to rise throughout the crop year. During the past decade—eliminating 1974/75 and 1980/81—average prices received during the last quarter have tended to be about 14 percent above the first-quarter average. If this pattern holds, soybean cash prices during the summer could average $7.00 a bushel.

It is also worth noting that we are likely to see, in future years, more intense competition between corn and soybeans in the Cornbelt. Additions to total row cropland will become increasingly costly and oats acreage has already decreased to a low level. Thus, the soybean/corn price ratio—ultimately the relative demand strength for the two crops—is likely to be more highly correlated with changes in soybean and corn acreage in coming years.

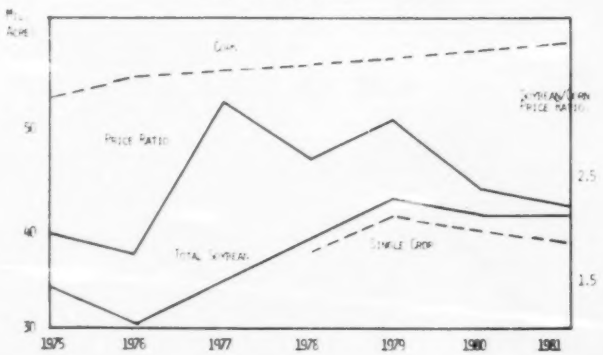
With grain and cotton prices also falling sharply in 1981/82, only minor adjustments in soybean acreage are likely next spring. So given the outlook for the livestock sector and overall economic activity, real soybean prices could be depressed again next fall, unless we have bad weather in 1982.

Peanuts—U.S. peanut production for 1981/82 is forecast to be about 4.0 billion pounds. This represents a sharp recovery from the drought-reduced 2.3 billion-pound 1980 crop. The recovery in production is a result of a 2,606 pound indicated yield per acre and a record harvested acreage of 1.53 million.

The large production will reduce the need for the very large imports of peanuts seen last year. The use of peanuts for food, crushings, and exports are all expected to show increases in 1982, and still leave a sizeable buildup in carryover stocks. The rebound in exports is unlikely to reach the levels hit in 1979/80. Imports of peanuts will be well below the 300 million pounds allowed into this country in 1981.

The large production indicates that a considerable amount of peanuts will sell close to the support levels, although some growers were able to contract a portion of their crops at a premium

Corn and Soybeans, Harvested Acreage and Price Ratio, Corn Belt



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to the support level. The farm price for peanuts in 1981/82 is likely to average around 23 to 24 cents a pound.

A major factor affecting the peanut outlook in 1982 and beyond will be the final provisions of the peanut program in the 1981 Farm Bill. The Senate version of that bill would eliminate acreage allotments and reduce marketing quotas to 1.24 million tons. The minimum support for quota peanuts would be set at $596 per ton for 1982, with cost of production adjustments to be made for the 1983 to 1985 crops. Peanuts over quota levels would continue to receive a $250 per ton support. The House version of the peanut provisions would eliminate allotments and poundage quotas and the support level would be determined at the discretion of the Secretary of Agriculture. The resulting compromise legislation will most assuredly have a large influence on the future of the peanut industry.

Fibers.

Cotton—The outlook for cotton in 1982 is dominated by the largest cotton crop in almost three decades. Additional factors affecting the cotton market include slower cotton consumption increases, rising stock levels and weaker prices, at least through the first half of 1982.

November prospects indicate a record 1981/82 world cotton production of 70.9 million bales, an 8-percent increase over the previous year. Cotton production in the U.S. is expected to increase 39 percent, reaching a 28-year high level of 15.5 million bales.

Total utilization of the U.S. cotton crop depends on the volume of exports and the domestic mill usage. Exports are expected to exceed domestic mill usage for a third consecutive year. The level of exports should increase modestly in 1982, due to lower U.S. prices.

Domestic mill usage will be determined in large part by the condition of the U.S. economy. Many economic forecasts suggest sluggish GNP growth with some declines in interest and inflation rates through the first half of 1982. High interest rates have at least two major effects on domestic mill usage. First, they increase the cost of holding inventories of both raw and processed cotton. Second, they lead to slower economic growth and less spending on textiles.

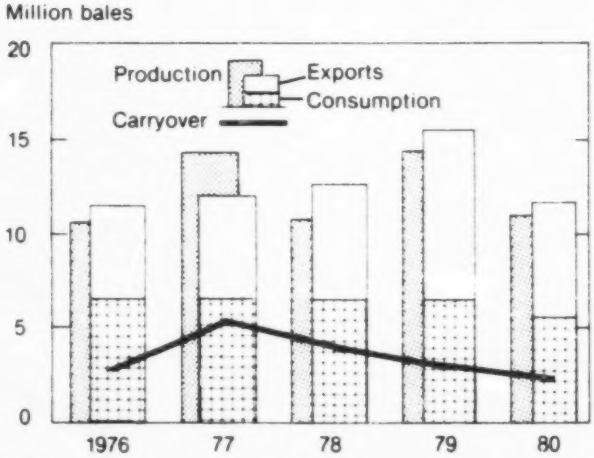
With production of cotton exceeding expected usage, both domestic and foreign stocks are expected to increase. The ratio of cotton stocks to usage is forecast at 38 percent (5 million bales in stocks and 13.2 million bales in total usage) for 1981/82. This is up from the 24 percent stock-to-usage ratio in 1980/81. This situation indicates that cotton prices may remain near current levels. Deficiency payments are being made.

Other factors affecting the cotton market include possible changes in the denim and corduroy markets which account for 25 to 30 percent of cotton mill usage. There are indications that consumers have the optimal inventories of denim and will buy now primarily for replacement. Substitute constructions such as stretch denim made from spandex and polyester filament, along with the increasing popularity of lightweight casual slacks, may also slow any major mill turnaround for denim and corduroy.

Other Crops and Specialties.

Tobacco—Once again, the tobacco industry is experiencing favorable conditions and the near term outlook is reasonably bright. But for the first time since it was established in 1938, the tobacco price support and loan program has come under serious question. It survived challenges in both the House and Senate during consideration of the 1981 Farm Bill, but the escape may be short-lived.

Cotton Production, Use and Carryover



Year beginning August 1. 480 pound net weight bales. Ending carryover 1980 preliminary

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USDA has been mandated to develop an acceptable no-cost alternative within current provisions by early 1982. Despite their relatively low direct cost to the Federal Government, provisions such as marketing quotas, high support prices, and allotment ownership by nonfarmers have been sharply criticized.

Tobacco production in 1981 was up 14 percent from 1980 due to increased acreage and yields. Both the quality of tobacco and prices at flue-cured auctions are yielding record cash receipts. Based on the formula required by law for establishing market quotas for all types of tobacco, the 1982 price support for eligible tobaccos will increase an estimated 11 percent over 1981.

The November 1, 1981, estimate of U.S. tobacco output was 2.03 billion pounds. Estimated ending stocks going into the marketing year were 3.28 billion pounds, about the same as a year earlier. Considering all tobacco products, exports and imports are expected to increase slightly in 1982.

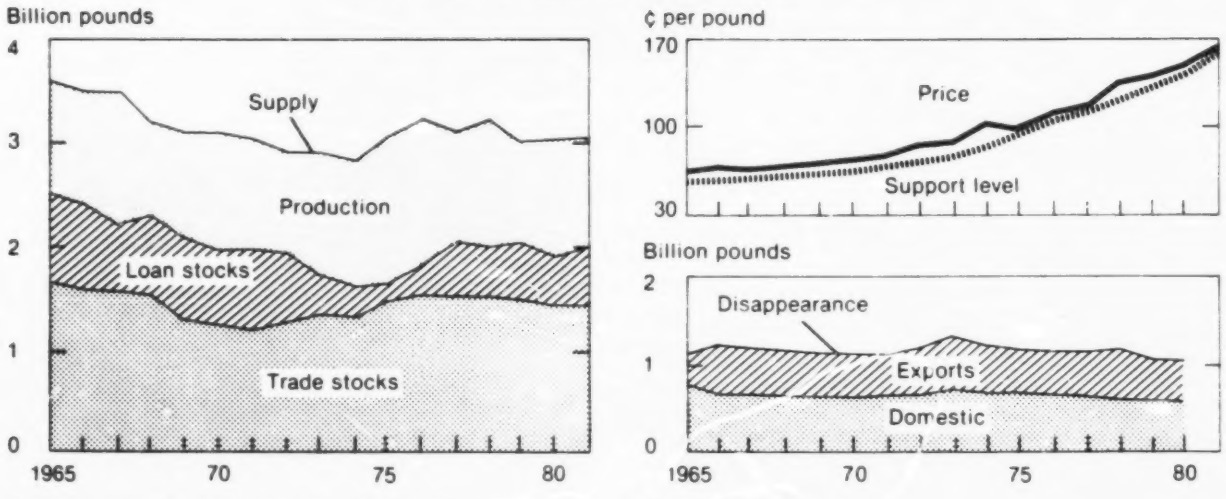
The near-term outlook for financing of tobacco producers is fairly bright. The overall stability of the tobacco crop, along with current crop insurance programs, creates a positive atmosphere for agricultural lenders. Crop sales in 1981 of $3.25 billion would be 25 percent higher than in 1980. Tobacco production costs were up about 10 percent from 1980. Effective quotas are likely to drop for next year, such that a smaller crop and higher prices suggest only a small increase in value.

The cost of producing an acre of flue-cured tobacco totaled about 10 percent higher in 1981 than 1980. In comparison, costs rose by 15 percent in 1980. Key factors in the slower rate of increase are the much smaller rise in fuel and fertilizer costs and an estimated slower rise in machinery costs. The 1981 estimates indicate the total cost to produce one acre of flue-cured tobacco (less management expenses, land and quota) was $1,847. Average yield per acre in 1981 is expected to be 2,102 pounds. Based on $1.65 per pound (September price), an acre of tobacco should net approximately $1,520 on the average.

Tobacco has been and continues to be one of the most stable income crops grown in the Southeastern United States and around the world. Generally, trends indicate a gradual change in almost all aspects of the tobacco industry, with the only negative influences having been provided by overall economic conditions and health concerns. Although costs continue to rise, tobacco production and prices should keep pace. The future for various participants in tobacco production will be greatly determined by what shape a new tobacco program takes.

Sugar—The current sugar situation is perhaps more critical than at any other time in recent years. In the near term, the market is absorbing one of the largest sugar crops on both the domestic and worldwide level. In the longer term, the sugar outlook will be greatly affected by the

Flue-Cured Tobacco: Supply, Price, Use



Trade stocks include manufacturers' and dealers' Crop year beginning July 1 1980 preliminary, 1981 forecast

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final outcome on current sugar legislation and the increasing competitiveness of corn sweeteners.

U.S. production in 1981/82 of cane and beet sugar is expected to total a near-record 6.2 million tons. This increase in output is primarily a result of expanded acreage, due to favorable prices at planting time, and of improved productivity. Sugar beet production in 1981/82 is estimated at 3.3 million tons, a 7-percent increase from 1980/81 levels. Sugarcane production in 1981/82 is estimated at 2.9 million tons, up 6.1 percent from the previous year. Domestic sugar stocks are predicted to increase as the large production outweighs expected lower imports and increased exports of sugar.

The production and usage of corn sweeteners continue to increase. The rate of production increase, however, is expected to slow as the price of corn sweeteners drops along with sugar prices. Most of this increased usage has been in liquid sugar primarily used in making beverages.

In the face of this high worldwide production of sugar, prices are expected to remain well below 1980's average price of 30.1 cents. The sugar outlook also turns on the final outcome of pending sugar legislation.

Potatoes—Fall crop production increased 8 percent in 1981, but was still 3 percent below 1979 levels. Strong demand in both the fresh and processed markets will result in good farm prices for the 1981 potato crop, though lower than for the short crop of 1980. Prices will likely average $4.75 to $5.25 per cwt., down from the 1980 fall crop average of $6.55 per cwt.

The record-high prices for the 1980 fall crop encouraged large increases in 1981 plantings in the Central and especially in the Western states. Acreage harvested was 6 percent above 1980, although still 3 percent below 1979. Regional fall production is estimated as follows:

	Million CWT	% Change
Eastern fall states	45.9	+ 9
Central states	63.2	+ 16
Western states	178.0	+ 5
Total	**287.1**	**+ 8**

Processor demand will be strong. Stocks declined 18 percent because processors were reluctant to buy potatoes at the high open-market prices in the spring of 1981. Processors in several areas have signed new contracts for delivery of 1981 fall potatoes at prices 20 to 30 percent above 1980 crop levels. The dehydrated potato market did not accumulate an increase in inventories in 1981.

Export sales of fresh tablestock and seed potatoes strengthened slightly in 1981. Even though the larger crop will result in lower prices in 1982, export sales are unlikely to increase substantially because prices are still relatively high, and the strong dollar discourages foreign buyers. Exports of dehydrated products dropped about 13,000 tons (33 percent) in the 1980/81 season.

Favorable exchange rates stimulated imports from Canada of 2.1 million cwt. of fresh tablestock from October 1980 to May 1981, more than double the imports for the comparable period of the previous year. Imports were especially heavy from New Brunswick and Prince Edward Island.

Fresh Vegetables—The outlook for fresh vegetables during 1982 is mixed. The first quarter should be a continuation of last year when, led by declines in lettuce and tomato production, fresh vegetable output fell 10 percent. Of the 14 principal vegetables, only broccoli production increased. Combined with strong demand, this production decline resulted in a 20-percent increase in the 1981 farm price index for fresh vegetables; this compares to a 4-percent annual rate of increase in farm prices for fresh vegetables during the 1977-80 period.

Through the first quarter of 1982, supplies should continue to be tight and prices should remain high for all major fresh vegetables, except broccoli and cabbage. Due to higher 1981 prices, larger plantings and increased supplies are indicated for most major vegetables during the spring and summer of 1982. Although larger supplies will weaken grower and retail prices, strong processor demand for some vegetables will offset some of the effect of higher supplies in many vegetables.

Processed Vegetables—Lower production and reduced carryover stocks of most processing vegetables are expected to result in higher farm prices, with a total farm value 21 percent above that of the 1980/81 crop. Production in 1981 declined due to both lower yields and less contracted acreage.

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Despite lower production in 1981, the pack of canned vegetables in 1981 should equal 1980. The pack of frozen vegetables will be down slightly. Since most carryovers are down (12 percent for canned vegetables, 4 percent for all frozen vegetables, and 40 percent for the seven leading frozen vegetables), total supplies will be somewhat tight this year. Canned supplies will be down 2 percent and frozen supplies down 8 percent.

Processing costs increased substantially this past year: packaging materials were up 7.5 percent; labor 11 percent; fuel and power 19.9 percent; and transportation 18.7 percent. Higher farm prices and the somewhat tight supplies should result in higher wholesale and retail prices. Per-capita consumption of both frozen and canned products declined in 1980/81, and since the decline is attributed in part to higher retail prices and small supplies, we could see a price effect again for the 1981/82 season.

Supplies of tomatoes and tomato products, green peas, and beets will be particularly tight. Farm, retail, and wholesale prices for tomato products should increase. Carryover stocks were not large, contracted acreage was down, and yields were diminished by poor growing conditions in California. Both canned and frozen pea packs were down for the third year in a row and total supplies (carryover plus pack) are barely above annual volume consumed. Prices for peas are expected to advance in the first half of 1982. Large carryovers in canned snap beans should result in some weakness in their wholesale prices while short carryovers in frozen snap beans will probably generate rising prices. Reduced yields and carryover of frozen lima beans have resulted in total supplies only slightly larger than annual consumption; prices should rise shortly. Supplies of canned lima beans will be ample and prices will probably remain stable throughout the 1981/82 marketing season. Sweet corn's small carryover will be offset by increased pack, and total supplies will be 2 percent greater than 1980/81, although still 12 percent less than 1979/80. Increased processing and marketing costs will keep retail and wholesale prices near last year's levels. Thus consumption should be about average and stocks carried over in 1982/83 should be adequate, about 5 to 7 million cases.

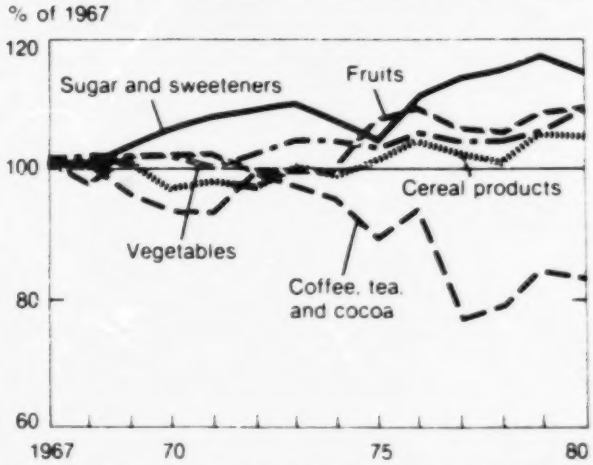
Fruits and Nuts—Reversing the upward trend of the last several years, total production of citrus and noncitrus fruit is projected to fall during the 1981/82 season. Every major fruit, except nectarines and lemons, should experience a decrease. Citrus production could be off 4 percent, while noncitrus production is down 15 percent.

Total citrus production for 1981/82 is projected at 14.4 million tons, down 4 percent from a year earlier and 12 percent below the 1979/80 record crop. Smaller crops are indicated for oranges, lemons, and tangerines. Despite a smaller Florida orange crop, a higher juice yield will result in a moderately larger pack of frozen concentrate orange juice (FCOJ) for 1981/82. FCOJ yield is forecast at 1.42 gallons a box, compared to 1.26 gallons a box on a 42.0 degree BRIX equivalent in 1980/81. Additionally, Florida packers will reduce the concentrate of FCOJ BRIX from 43.4 degrees to 42.0 degrees; this change will also increase the size of the pack.

Although the 1981/82 pack of most noncitrus fruit is less than a year ago, larger carryovers will ensure that supplies will remain adequate. In spite of adequate supplies and softer grower prices, retail prices should remain firm due to increased processing and markeing costs.

In the long run, two additional factors need to be considered. First, although production declined during 1980/81 and a further decline is projected for 1981/82, the bearing acreage of most fruit continues to increase. Consequently, production is still likely to resume its upward trend in the future.

Per-Capita Consumption of Selected Crop Products



Vegetables exclude potatoes, peas, and beans. Fruits exclude melons. 1980 preliminary.

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Second, if California fails to control the Mediterranean fruit fly infestation, a number of export markets could be restricted or closed; this would have significant impacts on grower prices during the 1982/83 season.

Of the four major edible tree nuts, only filberts are below last year's production. The 1981 almond crop is up 40 percent to a new record level. Although a 25-percent reserve has been established by the Secretary of Agriculture under the authority of the Marketing Order, world almond production is also up sharply. The pecan crop is 79 percent above the 1980 drought-stricken crop and the walnut crop was also up substantially. With carry-in levels close to last year, total United States supplies of tree nuts are signficantly higher for the 1981/82 marketing season.

Timber and Products—The key factor in determining the demand for many timber products is construction activity, most particularly, residential construction. New housing activity, which in recent years has accounted for more than 40 percent of U.S. lumber and plywood consumption, declined fairly rapidly through the first three quarters of 1981. Final figures are not available for 1981, but building starts are estimated at 1.0 million units—20 percent below 1980 and only a little over half the number started in 1977 and 1978.

Most economists expect the adverse elements currently affecting the housing markets to continue into 1982. Predicted on the probability of some improvement in interest rates, estimates for 1982 are for about 1.3 to 1.4 million units, with the highest level of starts in the second half of the year.

In view of the currently depressed housing industry and its adverse impact on lumber prices, paper prices can be expected to play an increasingly important role in the general outlook for the timber industry. Costs associated with the production of standing timber are relatively small when compared to harvesting and processing costs; however, fixed costs of processing are a very important consideration.

Given the trends in consumption, trade, and production for the various products, 1981 U.S. production and consumption is expected to be sharply under 1980 levels. Some rise in consumption and production can be expected in 1982 if the various markets, particularly housing, make some improvement.

The longer run outlook is one of more rapid growth. The demand for housing, for example, is expected to reach about 2.5 million units by the late 1980s. Projected increases in population and income in the 1980s and beyond also suggest continued and substantial growth in the container and non-residential construction markets and in the demand for paper products.

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